UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-K

FOR ANNUAL AND TRANSITION REPORTS PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

(Mark One)

☑ **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the fiscal year ended December 31, 2005

OR

☐ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the transition period from to .

Commission file number 0-29752

LEAP WIRELESS INTERNATIONAL, INC.
(Exact Name of Registrant as Specified in its Charter)

Delaware	**33-0811062**
(State or Other Jurisdiction of Incorporation or Organization)	**(I.R.S. Employer Identification No.)**
10307 Pacific Center Court, San Diego, CA	**92121**
(Address of Principal Executive Offices)	**(Zip Code)**

(858) 882-6000
(Registrant's Telephone Number, Including Area Code)

Securities registered pursuant to Section 12(b) of the Act:
None.

Securities registered pursuant to Section 12(g) of the Act:
Common Stock, $.0001 par value
(Title of Class)

Indicate by check mark whether the registrant is a well-known seasoned issuer as defined in Rule 405 of the Securities Act. YES ☐ NO ☑

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. YES ☐ NO ☑

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding twelve months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. YES ☑ NO ☐

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ☐

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act.

Large accelerated filer ☑ Accelerated filer ☐ Non-accelerated filer ☐

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ☐ No ☑

As of June 30, 2005, the aggregate market value of the registrant's voting and nonvoting common stock held by non-affiliates of the registrant was approximately $1,201,188,000, based on the closing price of Leap's common stock on the NASDAQ on June 30, 2005, of $27.75 per share.

Indicate by check mark whether the registrant has filed all documents and reports required to be filed by Section 12, 13 or 15(d) of the Securities Exchange Act of 1934 subsequent to the distribution of securities under a plan confirmed by a court. Yes ☑ No ☐

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Item 1A. *Risk Factors*

Risks Related to Our Business and Industry

We Have Experienced Net Losses, and We May Not Be Profitable in the Future.

We experienced net losses of $8.4 million and $49.3 million (excluding reorganization items, net) for the five months ended December 31, 2004 and the seven months ended July 31, 2004, respectively. In addition, we experienced net losses of $597.4 million for the year ended December 31, 2003, $664.8 million for the year ended December 31, 2002 and $483.3 million for the year ended December 31, 2001. Although we had net income of $30.0 million for the year ended December 31, 2005, we may not generate profits in the future on a consistent basis, or at all. If we fail to achieve consistent profitability, that failure could have a negative effect on our financial condition.

We May Not Be Successful in Increasing Our Customer Base Which Would Negatively Affect Our Business Plans and Financial Outlook.

Our growth on a quarter-by-quarter basis has varied substantially in the past. We believe that this uneven growth generally reflects seasonal trends in customer activity, promotional activity, the competition in the wireless telecommunications market, our reduction in spending on capital investments and advertising while we were in bankruptcy, and varying national economic conditions. Our current business plans assume that we will increase our customer base over time, providing us with increased economies of scale. If we are unable to attract and retain a growing customer base, our current business plans and financial outlook may be harmed.

If We Experience High Rates of Customer Turnover or Credit Card Subscription or Dealer Fraud, Our Ability to Become Profitable Will Decrease.

Because we do not require customers to sign fixed-term contracts or pass a credit check, our service is available to a broader customer base than many other wireless providers and, as a result, some of our customers may be more likely to terminate service due to an inability to pay than the average industry customer, particularly during economic downturns. In addition, our rate of customer turnover may be affected by other factors, including the size of our calling areas, our handset or service offerings, customer care concerns, number portability and other competitive factors. Our strategies to address customer turnover may not be successful. A high rate of customer turnover would reduce revenues and increase the total marketing expenditures required to attract the minimum number of replacement customers required to sustain our business plan, which, in turn, could have a material adverse effect on our business, financial condition and results of operations.

Our operating costs can also increase substantially as a result of customer credit card and subscription fraud and dealer fraud. We have implemented a number of strategies and processes to detect and prevent efforts to defraud us, and we believe that our efforts have substantially reduced the types of fraud we have identified. However, if our strategies are not successful in detecting and controlling fraud in the future, it could have a material adverse impact on our financial condition and results of operations.

We Have Made Significant Investment, and Will Continue to Invest, in Joint Ventures and Designated Entities, including ANB 1 and LCW Wireless, That We Do Not Control.

In November 2004, we acquired a 75% non-controlling interest in ANB 1, whose wholly owned subsidiary was awarded certain licenses in Auction #58. In November 2005, we entered into an agreement pursuant to which we will acquire a 73.3% non-controlling interest in LCW Wireless, which owns a wireless license for the Portland, Oregon market and to which we expect to contribute two wireless licenses and our operating assets in Eugene and Salem, Oregon. Our participation in these joint ventures is structured as a non-controlling interest in order to comply with FCC rules and regulations. We have agreements with our joint venture partner in ANB 1 and we plan to have similar agreements in connection with future joint venture arrangements we may enter into that are intended to allow us to actively participate in the development of the business of the joint venture. However, these agreements do not provide us with control over the business strategy, financial goals, build-out plans or other operational aspects of any such joint venture. The FCC's rules restrict our

ability to acquire controlling interests in such entities during the period that such entities must maintain their eligibility as a designated entity, as defined by the FCC. The entities that control the joint ventures may have interests and goals that are inconsistent or different from ours which could result in the joint venture taking actions that negatively impact our business or financial condition. In addition, if any of the other members of a joint venture files for bankruptcy or otherwise fails to perform its obligations or does not manage the joint venture effectively, we may lose our equity investment in, and any present or future rights to acquire the assets (including wireless licenses) of, such entity.

We Face Increasing Competition Which Could Have a Material Adverse Effect on Demand for the Cricket Service.

In general, the telecommunications industry is very competitive. Some competitors have announced rate plans substantially similar to Cricket's service plans (and have also introduced products that consumers perceive to be similar to Cricket's service plans) in markets in which we offer wireless service. In addition, the competitive pressures of the wireless telecommunications market have caused other carriers to offer service plans with large bundles of minutes of use at low prices which are competing with the predictable and unlimited Cricket calling plans. Some competitors also offer prepaid wireless plans that are being advertised heavily to demographic segments that are strongly represented in Cricket's customer base. These competitive offerings could adversely affect our ability to maintain our pricing and increase or maintain our market penetration. Our competitors may attract more customers because of their stronger market presence and geographic reach. Potential customers may perceive the Cricket service to be less appealing than other wireless plans, which offer more features and options. In addition, existing carriers and potential non-traditional carriers are exploring or have announced the launch of service using new technologies and/or alternative delivery plans.

In addition, some of our competitors are able to offer their customers roaming services on a nationwide basis and at lower rates. We currently offer roaming services on a prepaid basis. Many competitors have substantially greater financial and other resources than we have, and we may not be able to compete successfully. Because of their size and bargaining power, our larger competitors may be able to purchase equipment, supplies and services at lower prices than we can. As consolidation in the industry creates even larger competitors, any purchasing advantages our competitors have may increase, as well as their bargaining power as wholesale providers of roaming services.

We also compete as a wireless alternative to landline service providers in the telecommunications industry. Wireline carriers are also offering unlimited national calling plans and bundled offerings that include wireless and data services. We may not be successful in the long term, or continue to be successful, in our efforts to persuade potential customers to adopt our wireless service in addition to, or in replacement of, their current landline service.

The FCC is pursuing policies designed to increase the number of wireless licenses available in each of our markets. For example, the FCC has adopted rules that allow the partitioning, disaggregation or leasing of PCS and other wireless licenses, and continues to allocate and auction additional spectrum that can be used for wireless services, which may increase the number of our competitors.

We Have Identified Material Weaknesses in Our Internal Control Over Financial Reporting, and Our Business and Stock Price May Be Adversely Affected If We Do Not Remediate All of These Material Weaknesses, or If We Have Other Material Weaknesses in Our Internal Control Over Financial Reporting.

In connection with their evaluations of our disclosure controls and procedures, our CEO and CFO have concluded that certain material weaknesses in our internal control over financial reporting existed: (i) as of September 30, 2004, December 31, 2004, March 31, 2005, June 30, 2005, September 30, 2005 and December 31, 2005 with respect to turnover and staffing levels in our accounting, financial reporting and tax departments (arising in part in connection with our now completed bankruptcy proceedings) and the preparation of our income tax provision, and (ii) as of December 31, 2004 and March 31, 2005 with respect to

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the application of lease-related accounting principles, fresh-start reporting oversight, and account reconciliation procedures. We believe we have adequately remediated the material weaknesses associated with lease accounting, fresh-start reporting oversight and account reconciliation procedures. We are engaged in remediation efforts with respect to the material weaknesses related to staffing levels and income tax provision preparation. For a description of these material weaknesses and the steps we are undertaking to remediate them, see "Item 9A. Controls and Procedures" contained in Part II of this report. The existence of one or more material weaknesses could result in errors in our financial statements, and substantial costs and resources may be required to rectify any internal control deficiencies. If we cannot produce reliable financial reports, investors could lose confidence in our reported financial information, the market price of our stock could decline significantly, we may be unable to obtain additional financing to operate and expand our business, and our business and financial condition could be harmed.

Our Internal Control Over Financial Reporting Was Not Effective as of December 31, 2005, and Our Business May Be Adversely Affected if We Are Not Able to Implement Effective Control Over Financial Reporting.

Section 404 of the Sarbanes-Oxley Act of 2002 requires companies to do a comprehensive evaluation of their internal control over financial reporting. To comply with this statute, we are required to document and test our internal control over financial reporting; our management is required to assess and issue a report concerning our internal control over financial reporting; and our independent registered public accounting firm is required to attest to and report on management's assessment. We are required to comply with Section 404 of the Sarbanes-Oxley Act in connection with the filing of this Annual Report on Form 10-K for the fiscal year ending December 31, 2005. We have conducted a rigorous review of our internal control over financial reporting in order to become compliant with the requirements of Section 404. The standards that must be met for management to assess our internal control over financial reporting are new and require significant documentation and testing. Our assessment identified the need for remediation of some aspects of our internal control over financial reporting. Our internal control over financial reporting has been subject to certain material weaknesses in the past and is currently subject to material weaknesses related to staffing levels and preparation of our income tax provision as described above and in "Item 9A Controls and Procedures." Our management concluded and our independent registered public accounting firm has attested and reported that our internal control over financial reporting was not effective as of December 31, 2005. If we are unable to implement effective control over financial reporting, investors could lose confidence in our reported financial information, we may be unable to obtain additional financing to operate and expand our business, and our business and financial condition could be harmed.

Our Primary Business Strategy May Not Succeed in the Long Term.

A major element of our business strategy is to offer consumers service plans that allow unlimited calls for a flat monthly rate without entering into a fixed-term contract or passing a credit check. However, unlike national wireless carriers, we do not seek to provide ubiquitous coverage across the U.S. or all major metropolitan centers, and instead have a smaller network footprint covering only the principal population centers of our various markets. This strategy may not prove to be successful in the long term. From time to time, we also evaluate our service offerings and the demands of our target customers and may modify, change or adjust our service offerings or offer new services. We cannot assure you that these service offerings will be successful or prove to be profitable.

We Expect to Incur Substantial Costs in Connection with the Build-Out of Our New Markets, and any Delays in the Build-Out of Our New Markets Could Adversely Affect Our Business.

Our ability to achieve our strategic objectives will depend in part on the successful, timely and cost-effective build-out of the networks associated with newly acquired FCC licenses, including those owned by ANB 1 License and LCW Wireless, into new markets that complement our clustering strategy or provide strategic expansion opportunities. Large scale construction projects such as the build-out of our new markets may suffer cost-overruns. In addition, the build-out of the networks may be delayed or adversely affected by a

Item 8. ***Financial Statements and Supplementary Data***

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders of Leap Wireless International, Inc.:

We have completed an integrated audit of Leap Wireless International, Inc.'s 2005 consolidated financial statements and of its internal control over financial reporting as of December 31, 2005 and an audit of its 2004 consolidated financial statements in accordance with the standards of the Public Company Accounting Oversight Board (United States). Our opinions, based on our audits, are presented below.

Consolidated Financial Statements

In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of operations, of cash flows and of stockholders' equity (deficit) present fairly, in all material respects, the financial position of Leap Wireless International, Inc. and its subsidiaries (Successor Company) at December 31, 2005 and 2004, and the results of their operations and their cash flows for the year ended December 31, 2005 and the five months ended December 31, 2004 in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit of financial statements includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As discussed in Note 2 to the consolidated financial statements, the United States Bankruptcy Court for the Southern District of California confirmed the Company's Fifth Amended Joint Plan of Reorganization (the "plan") on October 22, 2003. Consummation of the plan terminated all rights and interests of equity security holders as provided for in the plan. The plan was consummated on August 16, 2004 and the Company emerged from bankruptcy. In connection with its emergence from bankruptcy, the Company adopted fresh-start accounting as of July 31, 2004.

As discussed in Note 3, the Company has restated its 2004 consolidated financial statements.

Internal Control Over Financial Reporting

Also, we have audited management's assessment, included in Management's Report on Internal Control Over Financial Reporting appearing under Item 9A, that Leap Wireless International, Inc. did not maintain effective internal control over financial reporting as of December 31, 2005 because (1) the Company did not maintain a sufficient complement of personnel with the appropriate skills, training and Company-specific experience in its accounting, financial reporting and tax functions and (2) the Company did not maintain effective internal controls surrounding the preparation of its income tax provision based on criteria established in *Internal Control — Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express opinions on management's assessment and on the effectiveness of the Company's internal control over financial reporting based on our audit.

We conducted our audit of internal control over financial reporting in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. An audit of internal control over financial reporting includes

obtaining an understanding of internal control over financial reporting, evaluating management's assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we consider necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinions.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

A material weakness is a control deficiency, or combination of control deficiencies, that results in more than a remote likelihood that a material misstatement of the annual or interim financial statements will not be prevented or detected. The following material weaknesses have been identified and included in management's assessment as of December 31, 2005:

- The Company did not maintain a sufficient complement of personnel with the appropriate skills, training and Company-specific experience to identify and address the application of generally accepted accounting principles in complex or non-routine transactions. Specifically, the Company has experienced staff turnover, and as a result, has experienced a lack of knowledge transfer to new employees within its accounting, financial reporting and tax functions. In addition, the Company does not have a full-time director of its tax function. This control deficiency contributed to the material weakness described below. Additionally, this control deficiency could result in a misstatement of accounts and disclosures that would result in a material misstatement to the Company's interim or annual consolidated financial statements that would not be prevented or detected. Accordingly, management has determined that this control deficiency constitutes a material weakness.

- The Company did not maintain effective controls over its accounting for income taxes. Specifically, the Company did not have adequate controls designed and in place to ensure the completeness and accuracy of the deferred income tax provision and the related deferred tax assets and liabilities and the related goodwill in conformity with generally accepted accounting principles. This control deficiency resulted in the restatement of the Company's consolidated financial statements for the five months ended December 31, 2004 and the consolidated financial statements for the two months ended September 30, 2004 and the quarters ended March 31, 2005, June 30, 2005, and September 30, 2005, as well as audit adjustments to the 2005 annual consolidated financial statements. Additionally, this control deficiency could result in a misstatement of income tax expense, deferred tax assets and liabilities and the related goodwill that would result in a material misstatement to the Company's interim or annual consolidated financial statements that would not be prevented or detected. Accordingly, management has determined that this control deficiency constitutes a material weakness.

These material weaknesses were considered in determining the nature, timing, and extent of audit tests applied in our audit of the 2005 consolidated financial statements, and our opinion regarding the effectiveness of the Company's internal control over financial reporting does not affect our opinion on those consolidated financial statements.

In our opinion, management's assessment that Leap Wireless International, Inc. did not maintain effective internal control over financial reporting as of December 31, 2005 is fairly stated, in all material respects, based on criteria established in *Internal Control — Integrated Framework* issued by the COSO. Also, in our opinion, because of the effects of the material weaknesses described above on the achievement of the objectives of the control criteria, Leap Wireless International, Inc. has not maintained effective internal control over financial reporting as of December 31, 2005 based on criteria established in *Internal Control — Integrated Framework* issued by the COSO.

PricewaterhouseCoopers LLP

San Diego, California
March 21, 2006

Item 9. ***Changes in and Disagreements with Accountants on Accounting and Financial Disclosure***

None.

Item 9A. ***Controls and Procedures***

(a) Evaluation of Disclosure Controls and Procedures

The Company maintains disclosure controls and procedures that are designed to ensure that information required to be disclosed in the Company's Exchange Act reports is recorded, processed, summarized and reported within the time periods specified by the SEC and that such information is accumulated and communicated to management, including its chief executive officer ("CEO") and chief financial officer ("CFO"), as appropriate, to allow for timely decisions regarding required disclosure. In designing and evaluating the disclosure controls and procedures, management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, and management is required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures.

Management, with participation by the Company's CEO and CFO, has designed the Company's disclosure controls and procedures to provide reasonable assurance of achieving the desired objectives. As required by SEC Rule 13a-15(b), in connection with filing this Annual Report on Form 10-K, management conducted an evaluation, with the participation of the Company's CEO and CFO, of the effectiveness of the design and operation of the Company's disclosure controls and procedures, as such term is defined under Rule 13a-15(e) promulgated under the Securities Exchange Act of 1934, as of December 31, 2005, the end of the period covered by this report. Based upon that evaluation, the Company's CEO and CFO concluded that two control deficiencies which constituted material weaknesses, as discussed in subsection (b) below, existed in the Company's internal control over financial reporting as of December 31, 2005. As a result of these material weaknesses, the Company's CEO and CFO concluded that the Company's disclosure controls and procedures were not effective at the reasonable assurance level as of December 31, 2005.

In light of these material weaknesses, the Company performed additional analyses and procedures in order to conclude that its consolidated financial statements for the year ended December 31, 2005 and the five months ended December 31, 2004 (as restated), as well as its consolidated financial statements for the interim period ended September 30, 2004 (as restated) and the quarters ended March 31, 2005 (as restated), June 30, 2005 (as restated) and September 30, 2005 (as restated), were presented in accordance with accounting principles generally accepted in the United States of America for such financial statements. Accordingly, management believes that despite the Company's material weaknesses, the Company's consolidated financial statements for the year ended December 31, 2005 and five months ended December 31, 2004 (as restated), as well as its consolidated financial statements for the interim period ended September 30, 2004 (as restated) and the quarters ended March 31, 2005 (as restated), June 30, 2005 (as restated) and September 30, 2005 (as restated), are fairly presented, in all material respects, in accordance with generally accepted accounting principles.

(b) Management's Report on Internal Control over Financial Reporting

Management is responsible for establishing and maintaining adequate internal control over financial reporting for the Company as such term is defined under Rule 13a-15(f) promulgated under the Securities Exchange Act of 1934. Internal control over financial reporting refers to the process designed by, or under the supervision of, the Company's CEO and CFO, and effected by its board of directors, management and other personnel, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles, and includes those policies and procedures that:

1. Pertain to the maintenance of records that in reasonable detail accurately and fairly reflect the transactions and dispositions of the Company's assets;

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2. Provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures are being made only in accordance with authorization of the Company's management and directors; and

3. Provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the Company's assets that could have a material effect on the financial statements.

Due to inherent limitations, internal control over financial reporting may not prevent or detect misstatements. In addition, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Management has assessed the effectiveness of the Company's internal control over financial reporting as of December 31, 2005. In making this assessment, management used the criteria established in *Internal Control-Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

A material weakness is a control deficiency, or combination of control deficiencies, that results in more than a remote likelihood that a material misstatement of the annual or interim financial statements will not be prevented or detected. In connection with management's assessment of internal control over financial reporting, management identified the following material weaknesses as of December 31, 2005:

1. The Company did not maintain a sufficient complement of personnel with the appropriate skills, training and Company-specific experience to identify and address the application of generally accepted accounting principles in complex or non-routine transactions. Specifically, the Company has experienced staff turnover, and as a result, has experienced a lack of knowledge transfer to new employees within its accounting, financial reporting and tax functions. In addition, the Company does not have a full-time director of its tax function. This control deficiency contributed to the material weakness described below. Additionally, this control deficiency could result in a misstatement of accounts and disclosures that would result in a material misstatement to the Company's interim or annual consolidated financial statements that would not be prevented or detected. Accordingly, management has determined that this control deficiency constitutes a material weakness.

2. The Company did not maintain effective controls over its accounting for income taxes. Specifically, the Company did not have adequate controls designed and in place to ensure the completeness and accuracy of the deferred income tax provision and the related deferred tax assets and liabilities and the related goodwill in conformity with generally accepted accounting principles. This control deficiency resulted in the restatement of the Company's consolidated financial statements for the five months ended December 31, 2004 and the consolidated financial statements for the two months ended September 30, 2004 and the quarters ended March 31, 2005, June 30, 2005 and September 30, 2005, as well as audit adjustments to the 2005 annual consolidated financial statements. Additionally, this control deficiency could result in a misstatement of income tax expense, deferred tax assets and liabilities and the related goodwill that would result in a material misstatement to the Company's interim or annual consolidated financial statements that would not be prevented or detected. Accordingly, management has determined that this control deficiency constitutes a material weakness.

Based on their assessment, and because of the material weaknesses described above, management has concluded that the Company's internal control over financial reporting was not effective as of December 31, 2005, using the criteria established in *Internal Control-Integrated Framework* issued by the COSO.

Management's assessment of the effectiveness of internal control over financial reporting as of December 31, 2005 has been audited by PricewaterhouseCoopers LLP, an independent registered public accounting firm, as stated in their report which is included herein.

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

(Mark One)

☑ **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934.**

For the quarterly period ended March 31, 2006

OR

☐ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934.**

For the transition period from ______to ______.

Commission File Number 0-29752

Leap Wireless International, Inc.
(Exact name of registrant as specified in its charter)

Delaware **(State or other jurisdiction of incorporation or organization)**	**33-0811062** **(I.R.S. Employer Identification No.)**
10307 Pacific Center Court, San Diego, CA **(Address of principal executive offices)**	**92121** **(Zip Code)**

(858) 882-6000
(Registrant's telephone number, including area code)

Not applicable
(Former name, former address and former fiscal year, if changed since last reported)

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports) and (2) has been subject to such filing requirements for the past 90 days.
Yes ☑ No ☐

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act.
Large accelerated filer ☑ Accelerated filer ☐ Non-accelerated filer ☐

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ☐ No ☑

Indicate by check mark whether the registrant has filed all documents and reports required to be filed by Sections 12, 13 or 15(d) of the Securities Exchange Act of 1934 subsequent to the distribution of securities under a plan confirmed by a court. Yes ☑ No ☐

The number of shares of registrant's common stock outstanding on May 8, 2006 was 61,224,279.

As of March 31, 2006, net of the effect of the interest rate swap agreements described above, our outstanding floating rate indebtedness totaled $237.9 million. The primary base interest rate is the three month LIBOR. Assuming the outstanding balance on our floating rate indebtedness remains constant over a year, a 100 basis point increase in the interest rate would decrease pre-tax income and cash flow, net of the effect of the swap agreements, by approximately $2.4 million.

Hedging Policy: Our policy is to maintain interest rate hedges when required by credit agreements. We do not currently engage in any hedging activities against foreign currency exchange rates or for speculative purposes.

Item 4. Controls and Procedures.

(a) Evaluation of Disclosure Controls and Procedures

The Company maintains disclosure controls and procedures that are designed to ensure that information required to be disclosed in the Company's Exchange Act reports is recorded, processed, summarized and reported within the time periods specified by the SEC and that such information is accumulated and communicated to management, including its chief executive officer ("CEO") and chief financial officer ("CFO"), as appropriate, to allow for timely decisions regarding required disclosure. In designing and evaluating the disclosure controls and procedures, management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, and management is required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures.

Management, with participation by the Company's CEO and CFO, has designed the Company's disclosure controls and procedures to provide reasonable assurance of achieving the desired objectives. As required by SEC Rule 13a-15(b), in connection with filing this Quarterly Report on Form 10-Q, management conducted an evaluation, with the participation of the Company's CEO and CFO, of the effectiveness of the design and operation of the Company's disclosure controls and procedures, as such term is defined under Rule 13a-15(e) promulgated under the Securities Exchange Act of 1934, as of March 31, 2006, the end of the period covered by this report. Based upon that evaluation, the Company's CEO and CFO concluded that two control deficiencies, each of which constituted a material weakness, as discussed below, existed in the Company's internal control over financial reporting as of March 31, 2006. As a result of these material weaknesses, the Company's CEO and CFO concluded that the Company's disclosure controls and procedures were not effective at the reasonable assurance level as of March 31, 2006.

In light of these material weaknesses, the Company performed additional analyses and procedures in order to conclude that its consolidated financial statements for the year ended December 31, 2005 as well as its condensed consolidated financial statements included in this Quarterly Report on Form 10-Q were fairly stated in accordance with accounting principles generally accepted in the United States of America for such financial statements. Accordingly, management believes that despite the Company's material weaknesses, the Company's consolidated financial statements for the year ended December 31, 2005 as well as its condensed consolidated financial statements included in this Quarterly Report on Form 10-Q are fairly stated, in all material respects, in accordance with generally accepted accounting principles.

The material weaknesses and the steps the Company has taken to remediate the material weaknesses are described more fully as follows:

Insufficient Staffing in the Accounting, Financial Reporting and Tax Functions. The Company did not maintain a sufficient complement of personnel with the appropriate skills, training and Company-specific experience to identify and address the application of generally accepted accounting principles in complex or non-routine transactions. The Company has also experienced staff turnover, and as a result, has experienced a lack of knowledge transfer to new employees within its accounting, financial reporting and tax functions. In addition, the Company does not have a full-time leader of its tax function. This control deficiency could result in a misstatement of accounts and disclosures that would result in a material misstatement to the Company's interim or annual consolidated financial statements that would not be prevented or detected. Accordingly, management has determined that this control deficiency constitutes a material weakness.

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The Company has taken the following actions to remediate the material weakness related to insufficient staffing in its accounting, financial reporting and tax functions:

- The Company hired a new vice president, chief accounting officer in May 2005. This individual is a certified public accountant with over 19 years of experience as an accounting professional, including over 14 years of public accounting experience with Pricewaterhouse Coopers, LLP. He possesses a strong background in technical accounting and the application of generally accepted accounting principles.
- The Company has hired a number of key accounting personnel since February 2005 that are appropriately qualified and experienced to identify and apply technical accounting literature, including several new directors and managers.

Based on the new leadership and management in the accounting department and on its identification of certain of the historical errors in the Company's accounting for income taxes and the timely completion of this Quarterly Report on Form 10-Q, the Company believes that it has made substantial progress in addressing this material weakness as of March 31, 2006. However, the material weakness was not yet remediated as of such date. The Company expects that this material weakness will be fully remediated once it has filled the remaining key open management positions, including a full-time tax department leader, with qualified personnel and those personnel have had sufficient time in their positions.

This material weakness contributed to the following control deficiency, which is considered to be a material weakness.

Errors in the Accounting for Income Taxes. The Company did not maintain effective controls over its accounting for income taxes. Specifically, the Company did not have adequate controls designed and in place to ensure the completeness and accuracy of the deferred income tax provision and the related deferred tax assets and liabilities and the related goodwill in conformity with generally accepted accounting principles. This control deficiency resulted in the restatement of the Company's consolidated financial statements for the five months ended December 31, 2004, the two months ended September 30, 2004 and the quarters ended March 31, 2005, June 30, 2005 and September 30, 2005. This control deficiency could result in a misstatement of accounts and disclosures that would result in a material misstatement to the Company's interim or annual consolidated financial statements that would not be prevented or detected. Accordingly, management has determined that this control deficiency constitutes a material weakness.

The Company has taken the following actions to remediate the material weakness related to its accounting for income taxes:

- The Company has initiated a search for a qualified full-time tax department leader and continues to make this a priority. The Company has been actively recruiting for this position for several months, but has experienced difficulty in finding qualified applicants. Nevertheless, the Company is striving to fill the position as soon as possible.
- As part of its 2005 annual income tax provision, the Company improved its internal control over income tax accounting to establish detailed procedures for the preparation and review of the income tax provision, including review by the Company's chief accounting officer.
- The Company used experienced qualified consultants to assist management in interpreting and applying income tax accounting literature and preparing the Company's income tax provision for the quarter ended March 31, 2006 and the year ended December 31, 2005, and will continue to use such consultants in the future to obtain access to as much income tax accounting expertise as it needs. The Company recognizes, however, that a full-time tax department leader with appropriate tax accounting expertise is important for the Company to maintain effective internal controls on an ongoing basis.

certain large wireless carriers in negotiating terms for roaming arrangements that we believe are reasonable, and believe that consolidation has contributed significantly to such carriers' control over the terms and conditions of wholesale roaming services.

We also compete as a wireless alternative to landline service providers in the telecommunications industry. Wireline carriers are also offering unlimited national calling plans and bundled offerings that include wireless and data services. We may not be successful in the long term, or continue to be successful, in our efforts to persuade potential customers to adopt our wireless service in addition to, or in replacement of, their current landline service.

The FCC is pursuing policies designed to increase the number of wireless licenses available in each of our markets. For example, the FCC has adopted rules that allow the partitioning, disaggregation or leasing of PCS and other wireless licenses, and continues to allocate and auction additional spectrum that can be used for wireless services, which may increase the number of our competitors.

We Have Identified Material Weaknesses in Our Internal Control Over Financial Reporting, and Our Business and Stock Price May Be Adversely Affected If We Do Not Remediate All of These Material Weaknesses, or If We Have Other Material Weaknesses in Our Internal Control Over Financial Reporting.

In connection with their evaluations of our internal controls and procedures, our CEO and CFO have concluded that certain material weaknesses in our internal control over financial reporting existed as of September 30, 2004, December 31, 2004, March 31, 2005, June 30, 2005, September 30, 2005, December 31, 2005 and March 31, 2006 with respect to turnover and staffing levels in our accounting, financial reporting and tax departments and the preparation of our income tax provision, and as of December 31, 2004 and March 31, 2005 with respect to the application of lease-related accounting principles, fresh-start reporting oversight, and account reconciliation procedures. We believe we have adequately remediated the material weaknesses associated with lease accounting, fresh-start reporting oversight and account reconciliation procedures.

Although we are engaged in remediation efforts with respect to the material weaknesses related to staffing levels and income tax provision preparation, the existence of one or more material weaknesses could result in errors in our financial statements, and substantial costs and resources may be required to rectify any internal control deficiencies. If we cannot produce reliable financial reports, investors could lose confidence in our reported financial information, the market price of Leap's common stock could decline significantly, we may be unable to obtain additional financing to operate and expand our business, and our business and financial condition could be harmed. For a description of these material weaknesses and the steps we are undertaking to remediate them, see "Item 4. Controls and Procedures" contained in Part I of this report. We cannot assure you that we will be able to remediate these material weaknesses in a timely manner.

Our Internal Control Over Financial Reporting Was Not Effective as of December 31, 2005, and Our Business May Be Adversely Affected if We Are Not Able to Implement Effective Control Over Financial Reporting.

Section 404 of the Sarbanes-Oxley Act of 2002 requires companies to do a comprehensive evaluation of their internal control over financial reporting. To comply with this statute, we are required to document and test our internal control over financial reporting; our management is required to assess and issue a report concerning our internal control over financial reporting; and our independent registered public accounting firm is required to attest to and report on management's assessment. We were required to comply with Section 404 of the Sarbanes-Oxley Act in connection with the filing of our Annual Report on Form 10-K for the fiscal year ending December 31, 2005. We conducted a rigorous review of our internal control over financial reporting in order to become compliant with the requirements of Section 404. The standards that must be met for management to assess our internal control over financial reporting are new and require significant documentation and testing. Our assessment identified the need for remediation of some aspects of our internal control over financial reporting. Our internal control over financial reporting has been subject to certain material weaknesses in the past and is currently subject to material weaknesses related to staffing levels and preparation of our income tax provision as described in "Item 4. Controls and Procedures" in Part I of this report. Our management concluded and our independent registered public accounting

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firm has attested and reported that our internal control over financial reporting was not effective as of December 31, 2005. If we are unable to implement effective control over financial reporting, investors could lose confidence in our reported financial information and the market price of Leap's common stock could decline significantly, we may be unable to obtain additional financing to operate and expand our business, and our business and financial condition could be harmed.

Our Primary Business Strategy May Not Succeed in the Long Term.

A major element of our business strategy is to offer consumers service plans that allow unlimited calls for a flat monthly rate without entering into a fixed-term contract or passing a credit check. However, unlike national wireless carriers, we do not seek to provide ubiquitous coverage across the U.S. or all major metropolitan centers, and instead have a smaller network footprint covering only the principal population centers of our various markets. This strategy may not prove to be successful in the long term. From time to time, we also evaluate our service offerings and the demands of our target customers and may modify, change or adjust our service offerings or offer new services. We cannot assure you that these service offerings will be successful or prove to be profitable.

We Expect to Incur Substantial Costs in Connection with the Build-Out of Our New Markets, and any Delays or Cost Increases in the Build-Out of Our New Markets Could Adversely Affect Our Business.

Our ability to achieve our strategic objectives will depend in part on the successful, timely and cost-effective build-out of the networks associated with newly acquired FCC licenses, including those owned by ANB 1 License and LCW Wireless and any licenses we may acquire in Auction #66 or from third parties, into new markets that complement our clustering strategy or provide strategic expansion opportunities. Large scale construction projects such as the build-out of our new markets will require significant capital expenditures and may suffer cost-overruns. In addition, we may experience higher operating expenses for a period of time as we build out and after we launch our service in new markets. Any significant capital expenditures or increased operating expenses, including in connection with the build-out and launch of markets for any licenses that we may acquire in Auction #66, would negatively impact our earnings, OIBDA and free cash flow for those periods in which we incur such capital expenditures or increased operating expenses. In addition, the build-out of the networks may be delayed or adversely affected by a variety of factors, uncertainties and contingencies, such as natural disasters, difficulties in obtaining zoning permits or other regulatory approvals, our relationships with our joint venture partners, and the timely performance by third parties of their contractual obligations to construct portions of the networks. Any failure to complete the build-out of our new markets on budget or on time could delay the implementation of our clustering and strategic expansion strategies, and could have a material adverse effect on our results of operations and financial condition.

If We Are Unable to Manage Our Planned Growth, Our Operations Could Be Adversely Impacted.

We have experienced growth in a relatively short period of time and expect to continue to experience growth in the future in our existing and new markets. The management of such growth will require, among other things, continued development of our financial and management controls and management information systems, stringent control of costs, diligent management of our network infrastructure and its growth, increased spending associated with marketing activities and acquisition of new customers, the ability to attract and retain qualified management personnel and the training of new personnel. Failure to successfully manage our expected growth and development could have a material adverse effect on our business, financial condition and results of operations.

Our Indebtedness Could Adversely Affect Our Financial Health.

We have now and will continue to have a significant amount of indebtedness. As of March 31, 2006, our total outstanding indebtedness under our secured credit facility was $592.9 million. We also had $110 million available for borrowing under our revolving credit facility (which forms part of our secured credit facility). We plan to raise additional funds in the future, and we expect to obtain much of such capital through debt financing. The existing indebtedness under our secured credit facility bears interest at a variable rate, but we have entered into interest rate swap agreements with respect to $355 million of our indebtedness.

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

(Mark One)

☑ **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934.**

For the quarterly period ended June 30, 2006

OR

☐ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934.**

For the transition period from _____________to _____________.

Commission File Number 0-29752

Leap Wireless International, Inc.
(Exact name of registrant as specified in its charter)

Delaware **(State or other jurisdiction of incorporation or organization)**	**33-0811062** **(I.R.S. Employer Identification No.)**
10307 Pacific Center Court, San Diego, CA **(Address of principal executive offices)**	**92121** **(Zip Code)**

(858) 882-6000
(Registrant's telephone number, including area code)

Not applicable
(Former name, former address and former fiscal year, if changed since last reported)

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports) and (2) has been subject to such filing requirements for the past 90 days. Yes ☑ No ☐

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act.

Large accelerated filer ☑ Accelerated filer ☐ Non-accelerated filer ☐

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ☐ No ☑

Indicate by check mark whether the registrant has filed all documents and reports required to be filed by Sections 12, 13 or 15(d) of the Securities Exchange Act of 1934 subsequent to the distribution of securities under a plan confirmed by a court. Yes ☑ No ☐

The number of shares of registrant's common stock outstanding on August 1, 2006 was 61,254,519.

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purchases of licenses and a portion of the related build-out and initial operating costs for such licenses. Although we are currently negotiating definitive documents for an $850 million bridge loan facility for Auction #66 and we expect, subject to market conditions, to launch a forward equity sale of approximately $250 million of our common stock in connection with an underwritten public offering in the near future, we cannot assure you that such funds will be available to us on acceptable terms, or at all. See "Management's Discussion and Analysis of Financial Condition and Results of Operations — Liquidity and Capital Resources." Because our bidding strategy in Auction #66 may not be successful and prices for spectrum in Auction #66 may rise to levels that are not acceptable to us, we may not utilize all or a significant portion of this anticipated additional financing.

Item 3. Quantitative and Qualitative Disclosures About Market Risk.

Interest Rate Risk. As of June 30, 2006, we had $900 million in outstanding floating rate debt under our secured Credit Agreement. Changes in interest rates would not significantly affect the fair value of our outstanding indebtedness. The terms of our Credit Agreement require that we enter into interest rate hedging agreements in an amount equal to at least 50% of our outstanding indebtedness by December 31, 2006. In April 2005, we entered into interest rate swap agreements with respect to $250 million of our debt. These swap agreements effectively fix the interest rate on $250 million of the outstanding indebtedness at 6.7% through June 2007. In July 2005, we entered into another interest rate swap agreement with respect to a further $105 million of our indebtedness. This swap agreement effectively fixes the interest rate on $105 million of our indebtedness at 6.8% through June 2009.

As of June 30, 2006, net of the effect of the interest rate swap agreements described above, our outstanding floating rate indebtedness totaled $545 million. The primary base interest rate is three month LIBOR. Assuming the outstanding balance on our floating rate indebtedness remains constant over a year, a 100 basis point increase in the interest rate would decrease pre-tax income and cash flow, net of the effect of the swap agreements, by approximately $5.5 million.

Hedging Policy. Our policy is to maintain interest rate hedges when required by credit agreements. We do not currently engage in any hedging activities against foreign currency exchange rates or for speculative purposes.

Item 4. Controls and Procedures.

(a) Evaluation of Disclosure Controls and Procedures

The Company maintains disclosure controls and procedures that are designed to ensure that information required to be disclosed in the Company's Exchange Act reports is recorded, processed, summarized and reported within the time periods specified by the SEC and that such information is accumulated and communicated to management, including its chief executive officer ("CEO") and chief financial officer ("CFO"), as appropriate, to allow for timely decisions regarding required disclosure. In designing and evaluating the disclosure controls and procedures, management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, and management is required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures.

Management, with participation by the Company's CEO and CFO, has designed the Company's disclosure controls and procedures to provide reasonable assurance of achieving the desired objectives. As required by SEC Rule 13a-15(b), in connection with filing this Quarterly Report on Form 10-Q, management conducted an evaluation, with the participation of the Company's CEO and CFO, of the effectiveness of the design and operation of the Company's disclosure controls and procedures, as such term is defined under Rule 13a-15(e) promulgated under the Securities Exchange Act of 1934, as of June 30, 2006, the end of the period covered by this report. Based upon that evaluation, the Company's CEO and CFO concluded that two control deficiencies, each of which constituted a material weakness, as discussed below, existed in the Company's internal control over financial reporting as of June 30, 2006. As a result of these material weaknesses, the Company's CEO and CFO concluded that the Company's disclosure controls and procedures were not effective at the reasonable assurance level as of June 30, 2006.

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In light of these material weaknesses, the Company performed additional analyses and procedures in order to conclude that its condensed consolidated financial statements for the quarter ended June 30, 2006 were fairly stated in accordance with accounting principles generally accepted in the United States of America for such financial statements. Accordingly, management believes that despite the Company's material weaknesses, the Company's condensed consolidated financial statements for the quarter ended June 30, 2006 are fairly stated, in all material respects, in accordance with generally accepted accounting principles.

The material weaknesses and the steps the Company has taken to remediate the material weaknesses are described more fully as follows:

Insufficient Staffing in the Accounting, Financial Reporting and Tax Functions. The Company did not maintain a sufficient complement of personnel with the appropriate skills, training and Company-specific experience to identify and address the application of generally accepted accounting principles in complex or non-routine transactions. The Company has also experienced staff turnover and an associated loss of Company-specific experience within its accounting, financial reporting and tax functions. This control deficiency could result in a misstatement of accounts and disclosures that would result in a material misstatement to the Company's interim or annual consolidated financial statements that would not be prevented or detected. Accordingly, management has determined that this control deficiency constitutes a material weakness.

The Company has taken the following actions to remediate this material weakness:

- The Company hired a new vice president, chief accounting officer in May 2005. This individual is a certified public accountant with over 19 years of experience as an accounting professional, including over 14 years of public accounting experience with PricewaterhouseCoopers, LLP. He possesses a strong background in technical accounting and the application of generally accepted accounting principles in complex or non-routine transactions.

- The Company has hired a number of other key accounting personnel since February 2005 that are appropriately qualified and experienced to identify and apply technical accounting literature, including several new directors and managers.

- In June 2006, the Company hired a new director of tax to lead its tax function. This individual is a certified public accountant with over 19 years of experience as a tax professional, including over nine years with the tax practices of large public accounting firms. He possesses a strong background in interpreting and applying income tax accounting literature and preparing income tax provisions for public companies.

- The Company has used experienced qualified consultants to assist management in addressing the application of generally accepted accounting principles in complex or non-routine transactions for the quarters ended March 31, 2006 and June 30, 2006 and the year ended December 31, 2005, and will continue to use such consultants in the future, as needed, to supplement its existing staff.

Based on the new leadership and management in the accounting and tax functions, the Company's identification of certain of the historical errors in its accounting for income taxes and the timely completion of the Quarterly Reports on Form 10-Q for the first and second quarters of fiscal 2006, the Company believes that it has made substantial progress in addressing this material weakness as of June 30, 2006. The Company expects that this material weakness will be fully remediated once it has fully remediated the material weakness related to the accounting for income taxes, the new key accounting personnel have had sufficient time in their positions, and the Company demonstrates continued timely completion of its SEC reports.

This material weakness contributed to the following control deficiency, which is considered to be a material weakness.

Errors in the Accounting for Income Taxes. The Company did not maintain effective controls over its accounting for income taxes. Specifically, the Company did not have adequate controls designed and in place to ensure the completeness and accuracy of the deferred income tax provision and the related deferred tax assets and liabilities and the related goodwill in conformity with generally accepted accounting principles. This

control deficiency resulted in the restatement of the Company's consolidated financial statements for the five months ended December 31, 2004, the two months ended September 30, 2004 and the quarters ended March 31, 2005, June 30, 2005 and September 30, 2005. This control deficiency could result in a misstatement of accounts and disclosures that would result in a material misstatement to the Company's interim or annual consolidated financial statements that would not be prevented or detected. Accordingly, management has determined that this control deficiency constitutes a material weakness.

The Company has taken the following actions to remediate this material weakness:

- In June 2006, the Company hired a new director of tax to lead its tax function. This individual is a certified public accountant with over 19 years of experience as a tax professional, including over nine years with the tax practices of large public accounting firms. He possesses a strong background in interpreting and applying income tax accounting literature and preparing income tax provisions for public companies.
- As part of its 2005 annual income tax provision, the Company improved its internal control over income tax accounting to establish detailed procedures for the preparation and review of the income tax provision, including review by the Company's chief accounting officer.
- The Company used experienced qualified consultants to assist management in interpreting and applying income tax accounting literature and preparing the Company's income tax provision for the quarters ended March 31, 2006 and June 30, 2006 and the year ended December 31, 2005, and may continue to use such consultants in the future to obtain access to as much income tax accounting expertise as it needs.

As a result of the remediation initiatives described above, the Company identified certain of the errors that gave rise to the restatements of the consolidated financial statements for deferred income taxes. In addition, the Company prepared accurate and timely income tax provisions for the year ended December 31, 2005 and the first two quarters of fiscal 2006. Based on these remediation initiatives, the Company believes that it has made substantial progress in addressing this material weakness as of June 30, 2006. The Company expects that this material weakness will be fully remediated once the new leader of the tax department has had sufficient time in his position and the Company demonstrates continued accurate and timely preparation of its income tax provisions.

(b) Changes in Internal Control over Financial Reporting

There were no changes in the Company's internal control over financial reporting during the Company's fiscal quarter ended June 30, 2006 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

substantially greater financial and other resources than we have, and we may not be able to compete successfully. Because of their size and bargaining power, our larger competitors may be able to purchase equipment, supplies and services at lower prices and attract a larger number of dealers than we can. Prior to the launch of a large market in 2006, disruptions by a competitor interfered with our indirect dealer relationships, reducing the number of dealers offering Cricket service during the initial weeks of launch. As consolidation in the industry creates even larger competitors, any purchasing advantages our competitors have may increase, as well as their bargaining power as wholesale providers of roaming services. For example, in connection with the offering of our "Travel Time" roaming service, we have encountered problems with certain large wireless carriers in negotiating terms for roaming arrangements that we believe are reasonable, and believe that consolidation has contributed significantly to such carriers' control over the terms and conditions of wholesale roaming services.

We also compete as a wireless alternative to landline service providers in the telecommunications industry. Wireline carriers are also offering unlimited national calling plans and bundled offerings that include wireless and data services. We may not be successful in the long term, or continue to be successful, in our efforts to persuade potential customers to adopt our wireless service in addition to, or in replacement of, their current landline service.

The FCC is pursuing policies designed to increase the number of wireless licenses available in each of our markets. For example, the FCC has adopted rules that allow the partitioning, disaggregation and leasing of PCS and other wireless licenses, and continues to allocate and auction additional spectrum that can be used for wireless services, which may increase the number of our competitors.

We Have Identified Material Weaknesses in Our Internal Control Over Financial Reporting, and Our Business and Stock Price May Be Adversely Affected If We Do Not Remediate All of These Material Weaknesses, or If We Have Other Material Weaknesses in Our Internal Control Over Financial Reporting.

In connection with their evaluations of our disclosure controls and procedures, our CEO and CFO have concluded that certain material weaknesses in our internal control over financial reporting existed as of September 30, 2004, December 31, 2004, March 31, 2005, June 30, 2005, September 30, 2005, December 31, 2005, March 31, 2006 and June 30, 2006 with respect to turnover and staffing levels in our accounting, financial reporting and tax departments and the preparation of our income tax provision, and as of December 31, 2004 and March 31, 2005 with respect to the application of lease-related accounting principles, fresh-start reporting oversight, and account reconciliation procedures. We believe we have adequately remediated the material weaknesses associated with lease accounting, fresh-start reporting oversight and account reconciliation procedures.

Although we are engaged in remediation efforts with respect to the material weaknesses related to turnover and staffing and income tax provision preparation, the existence of one or more material weaknesses could result in errors in our financial statements, and substantial costs and resources may be required to rectify any internal control deficiencies. If we cannot produce reliable financial reports, investors could lose confidence in our reported financial information, the market price of Leap's common stock could decline significantly, we may be unable to obtain additional financing to operate and expand our business, and our business and financial condition could be harmed. For a description of these material weaknesses and the steps we are undertaking to remediate them, see "Item 4. Controls and Procedures" contained in Part I of this report. We cannot assure you that we will be able to remediate these material weaknesses in a timely manner.

Our Internal Control Over Financial Reporting Was Not Effective as of December 31, 2005, and Our Business May Be Adversely Affected if We Are Not Able to Implement Effective Control Over Financial Reporting.

Section 404 of the Sarbanes-Oxley Act of 2002 requires companies to do a comprehensive evaluation of their internal control over financial reporting. To comply with this statute, we are required to document and test our internal control over financial reporting; our management is required to assess and issue a report concerning our internal control over financial reporting; and our independent registered public accounting firm

is required to attest to and report on management's assessment and the effectiveness of internal control over financial reporting. We were required to comply with Section 404 of the Sarbanes-Oxley Act in connection with the filing of our Annual Report on Form 10-K for the year ended December 31, 2005. We conducted a rigorous review of our internal control over financial reporting in order to become compliant with the requirements of Section 404. The standards that must be met for management to assess our internal control over financial reporting are new and require significant documentation and testing. Our assessment identified the need for remediation of some aspects of our internal control over financial reporting. Our internal control over financial reporting has been subject to certain material weaknesses in the past and is currently subject to material weaknesses related to staffing levels and preparation of our income tax provision as described in "Item 4. Controls and Procedures" in Part I of this report. Our management concluded and our independent registered public accounting firm has attested and reported that our internal control over financial reporting was not effective as of December 31, 2005. If we are unable to implement effective control over financial reporting, investors could lose confidence in our reported financial information and the market price of Leap's common stock could decline significantly, we may be unable to obtain additional financing to operate and expand our business and our business and financial condition could be harmed.

Our Primary Business Strategy May Not Succeed in the Long Term.

A major element of our business strategy is to offer consumers service plans that allow unlimited calls for a flat monthly rate without entering into a fixed-term contract or passing a credit check. However, unlike national wireless carriers, we do not seek to provide ubiquitous coverage across the U.S. or all major metropolitan centers, and instead have a smaller network footprint covering only the principal population centers of our various markets. This strategy may not prove to be successful in the long term. From time to time, we also evaluate our service offerings and the demands of our target customers and may modify, change or adjust our service offerings or offer new services. We cannot assure you that these service offerings will be successful or prove to be profitable.

We Expect to Incur Substantial Costs in Connection with the Build-Out of Our New Markets, and any Delays or Cost Increases in the Build-Out of Our New Markets Could Adversely Affect Our Business.

Our ability to achieve our strategic objectives will depend in part on the successful, timely and cost-effective build-out of the networks associated with newly acquired FCC licenses, including those owned by ANB 1 License and LCW Wireless and any licenses we or Denali License may acquire in Auction #66 or from third parties. Large scale construction projects such as the build-out of our new markets will require significant capital expenditures and may suffer cost-overruns. In addition, we will experience higher operating expenses as we build out and after we launch our service in new markets. Any significant capital expenditures or increased operating expenses, including in connection with the build-out and launch of markets for any licenses that we or Denali License may acquire in Auction #66, would negatively impact our earnings and free cash flow for those periods in which we incur such capital expenditures or increased operating expenses. In addition, the build-out of the networks may be delayed or adversely affected by a variety of factors, uncertainties and contingencies, such as natural disasters, difficulties in obtaining zoning permits or other regulatory approvals, our relationships with our joint venture partners, and the timely performance by third parties of their contractual obligations to construct portions of the networks.

The spectrum that will be licensed in Auction #66 currently is used by U.S. federal government and/or incumbent commercial licensees. FCC rules require winning bidders to avoid interfering with these existing users or to clear the incumbent users from the spectrum through specified relocation procedures. We have considered the estimated cost and time frame required to clear the spectrum on which we intend to bid in the auction. However, the actual cost of clearing the spectrum may exceed our estimated costs. Furthermore, delays in the provision of federal funds to relocate government users, or difficulties in negotiating with incumbent commercial licensees, may extend the date by which the auctioned spectrum can be cleared of existing operations, and thus may also delay the date on which we can launch commercial services using such licensed spectrum. In addition, certain existing government operations are using the spectrum that is being

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

(Mark One)

☑ **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934.**

For the quarterly period ended September 30, 2006

OR

☐ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934.**

For the transition period from ______to ______.

Commission File Number 0-29752

Leap Wireless International, Inc.
(Exact name of registrant as specified in its charter)

Delaware (State or other jurisdiction of incorporation or organization)	**33-0811062** (I.R.S. Employer Identification No.)
10307 Pacific Center Court, San Diego, CA (Address of principal executive offices)	**92121** (Zip Code)

(858) 882-6000
(Registrant's telephone number, including area code)

Not applicable
(Former name, former address and former fiscal year, if changed since last reported)

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports) and (2) has been subject to such filing requirements for the past 90 days. Yes ☑ No ☐

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act.

Large accelerated filer ☑ Accelerated filer ☐ Non-accelerated filer ☐

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ☐ No ☑

Indicate by check mark whether the registrant has filed all documents and reports required to be filed by Sections 12, 13 or 15(d) of the Securities Exchange Act of 1934 subsequent to the distribution of securities under a plan confirmed by a court. Yes ☑ No ☐

The number of shares of registrant's common stock outstanding on November 1, 2006 was 67,763,650.

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Item 4. Controls and Procedures.

(a) Evaluation of Disclosure Controls and Procedures

The Company maintains disclosure controls and procedures that are designed to ensure that information required to be disclosed in the Company's Exchange Act reports is recorded, processed, summarized and reported within the time periods specified by the SEC and that such information is accumulated and communicated to management, including its chief executive officer (or CEO) and chief financial officer (or CFO), as appropriate, to allow for timely decisions regarding required disclosure. In designing and evaluating the disclosure controls and procedures, management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, and management is required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures.

Management, with participation by the Company's CEO and CFO, has designed the Company's disclosure controls and procedures to provide reasonable assurance of achieving the desired objectives. As required by SEC Rule 13a-15(b), in connection with filing this Quarterly Report on Form 10-Q, management conducted an evaluation, with the participation of the Company's CEO and CFO, of the effectiveness of the design and operation of the Company's disclosure controls and procedures, as such term is defined under Rule 13a-15(e) promulgated under the Securities Exchange Act of 1934, as of September 30, 2006, the end of the period covered by this report. Based upon that evaluation, the Company's CEO and CFO concluded that two control deficiencies, each of which constituted a material weakness, as discussed below, existed in the Company's internal control over financial reporting as of September 30, 2006. As a result of these material weaknesses, the Company's CEO and CFO concluded that the Company's disclosure controls and procedures were not effective at the reasonable assurance level as of September 30, 2006.

In light of these material weaknesses, the Company performed additional analyses and procedures in order to conclude that its condensed consolidated financial statements for the quarter ended September 30, 2006 were fairly stated in accordance with accounting principles generally accepted in the United States of America for such financial statements. Accordingly, management believes that despite the Company's material weaknesses, the Company's condensed consolidated financial statements for the quarter ended September 30, 2006 are fairly stated, in all material respects, in accordance with generally accepted accounting principles.

The material weaknesses and the steps the Company has taken to remediate the material weaknesses are described more fully as follows:

Insufficient Staffing in the Accounting, Financial Reporting and Tax Functions. The Company did not maintain a sufficient complement of personnel with the appropriate skills, training and Company-specific experience to identify and address the application of generally accepted accounting principles in complex or non-routine transactions. The Company has also experienced staff turnover and an associated loss of Company-specific experience within its accounting, financial reporting and tax functions. This control deficiency could result in a misstatement of accounts and disclosures that would result in a material misstatement to the Company's interim or annual consolidated financial statements that would not be prevented or detected. Accordingly, management has determined that this control deficiency constitutes a material weakness. The Company has taken the following actions to remediate this material weakness:

- The Company hired a new executive vice president, chief financial officer in August 2006. This individual has over 20 years of experience as a financial executive, including over seven years as a chief financial officer of public companies.
- The Company hired a new vice president, chief accounting officer in May 2005. This individual is a certified public accountant with over 19 years of experience as an accounting professional, including over 14 years of public accounting experience with PricewaterhouseCoopers, LLP. He possesses a strong background in technical accounting and the application of generally accepted accounting principles in complex or non-routine transactions.
- The Company hired a new assistant controller in October 2006. This individual is a certified public accountant with over 15 years of experience as an accounting executive with a large public company. She also possesses a strong background in technical accounting and the application of generally accepted accounting principles in complex or non-routine transactions.

- In June 2006, the Company hired a new director of tax to lead its tax function. This individual is a certified public accountant with over 19 years of experience as a tax professional, including over nine years with the tax practices of large public accounting firms. He possesses a strong background in interpreting and applying income tax accounting literature and preparing income tax provisions for public companies.
- The Company has hired a number of other key accounting personnel since February 2005 that are appropriately qualified and experienced to identify and apply technical accounting literature, including several new directors and managers.
- The Company has used experienced qualified consultants to assist management in addressing the application of generally accepted accounting principles in complex or non-routine transactions for the quarters ended September 30, 2006, June 30, 2006 and March 31, 2006 and the year ended December 31, 2005, and will continue to use such consultants in the future, as needed, to supplement its existing staff.

Based on the new leadership and management in the accounting and tax functions, the Company's identification of certain of the historical errors in its accounting for income taxes and the timely completion of the Quarterly Reports on Form 10-Q for the first, second and third quarters of fiscal 2006, the Company believes that it has made substantial progress in addressing this material weakness as of September 30, 2006. The Company expects that this material weakness will be fully remediated once it has fully remediated the material weakness related to the accounting for income taxes, and it demonstrates continued timely completion of its SEC reports, particularly the Annual Report on Form 10-K for the year ending December 31, 2006.

This material weakness contributed to the following control deficiency, which is considered to be a material weakness.

Errors in the Accounting for Income Taxes. The Company did not maintain effective controls over its accounting for income taxes. Specifically, the Company did not have adequate controls designed and in place to ensure the completeness and accuracy of the deferred income tax provision and the related deferred tax assets and liabilities and the related goodwill in conformity with generally accepted accounting principles. This control deficiency resulted in the restatement of the Company's consolidated financial statements for the five months ended December 31, 2004, the two months ended September 30, 2004 and the quarters ended March 31, 2005, June 30, 2005 and September 30, 2005. This control deficiency could result in a misstatement of accounts and disclosures that would result in a material misstatement to the Company's interim or annual consolidated financial statements that would not be prevented or detected. Accordingly, management has determined that this control deficiency constitutes a material weakness.

The Company has taken the following actions to remediate this material weakness:

- In June 2006, the Company hired a new director of tax to lead its tax function. This individual is a certified public accountant with over 19 years of experience as a tax professional, including over nine years with the tax practices of large public accounting firms. He possesses a strong background in interpreting and applying income tax accounting literature and preparing income tax provisions for public companies.
- As part of its 2005 annual income tax provision, the Company improved its internal control over income tax accounting to establish detailed procedures for the preparation and review of the income tax provision, including review by the Company's chief accounting officer.
- The Company used experienced qualified consultants to assist management in interpreting and applying income tax accounting literature and preparing the Company's income tax provision for the quarters ended September 30, 2006, June 30, 2006 and March 31, 2006 and the year ended December 31, 2005, and may continue to use such consultants in the future to obtain access to as much income tax accounting expertise as it needs.

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-K

ANNUAL REPORT
PURSUANT TO SECTION 13 OR 15(d) OF THE
SECURITIES EXCHANGE ACT OF 1934

(Mark One)

☑ **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the fiscal year ended December 31, 2006

OR

☐ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the transition period from ______ to ______.

Commission file number 0-29752

LEAP WIRELESS INTERNATIONAL, INC.
(Exact Name of Registrant as Specified in its Charter)

Delaware	**33-0811062**
(State or Other Jurisdiction of Incorporation or Organization)	**(I.R.S. Employer Identification No.)**
10307 Pacific Center Court, San Diego, CA	**92121**
(Address of Principal Executive Offices)	**(Zip Code)**

(858) 882-6000
(Registrant's Telephone Number, Including Area Code)

Securities registered pursuant to Section 12(b) of the Act:

Title of Each Class	**Name of Each Exchange on Which Registered**
Common Stock, $.0001 par value	**The NASDAQ Stock Market, LLC**

Securities registered pursuant to Section 12(g) of the Act:
None.

Indicate by check mark whether the registrant is a well-known seasoned issuer as defined in Rule 405 of the Securities Act. YES ☑ NO ☐

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. YES ☐ NO ☑

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding twelve months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. YES ☑ NO ☐

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ☐

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act.
Large accelerated filer ☑ Accelerated filer ☐ Non-accelerated filer ☐

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ☐ No ☑

As of June 30, 2006, the aggregate market value of the registrant's voting and nonvoting common stock held by non-affiliates of the registrant was approximately $1,703,253,000, based on the closing price of Leap's common stock on the NASDAQ National Market on June 30, 2006, of $47.45 per share.

Indicate by check mark whether the registrant has filed all documents and reports required to be filed by Section 12, 13 or 15 (d) of the Securities Exchange Act of 1934 subsequent to the distribution of securities under a plan confirmed by a court. Yes ☑ No ☐

The number of shares of registrant's common stock outstanding on February 23, 2007 was 67,909,011.

The FCC is pursuing policies designed to increase the number of wireless licenses available in each of our markets. For example, the FCC has adopted rules that allow the partitioning, disaggregation or leasing of PCS and other wireless licenses, and continues to allocate and auction additional spectrum that can be used for wireless services, which may increase the number of our competitors.

Our ability to remain competitive will depend, in part, on our ability to anticipate and respond to various competitive factors and to keep our costs low.

We May Be Unable to Obtain the Roaming Services We Need From Other Carriers to Remain Competitive

Many of our competitors have regional or national networks which enable them to offer automatic roaming services to their subscribers at a lower cost than we can offer. We do not have a national network, and we must pay fees to other carriers who provide roaming services to us. We currently have roaming agreements with several other carriers which allow our customers to roam on those carriers' networks. The roaming agreements generally cover voice but not data services, and at least one such agreement may be terminated on relatively short notice. In addition, we believe that the rates charged to us by some of these carriers are higher than the rates they charge to certain other roaming partners. Our current and future customers may prefer that we offer roaming services that allow them to make calls automatically when they are outside of their Cricket service area, and we cannot assure you that we will be able to provide such roaming services for our customers in all areas of the U.S., or that we will be able to provide such services cost effectively. If we are unable to maintain our existing roaming agreements, and purchase wholesale roaming services at reasonable rates, then we may be unable to compete effectively for wireless customers, which may increase our churn and decrease our revenues, which could materially adversely affect our business, financial condition and results of operations.

We Previously Identified Material Weaknesses in Our Internal Control Over Financial Reporting, and Our Business and Stock Price May Be Adversely Affected If Our Internal Controls Are Not Effective.

Section 404 of the Sarbanes-Oxley Act of 2002 requires companies to do a comprehensive evaluation of their internal control over financial reporting. To comply with this statute, we are required to document and test our internal control over financial reporting; our management is required to assess and issue a report concerning our internal control over financial reporting; and our independent registered public accounting firm is required to attest to and report on management's assessment and the effectiveness of internal control over financial reporting. In connection with their evaluations of our disclosure controls and procedures, our Chief Executive Officer, or CEO, and Chief Financial Officer, or CFO, concluded that certain material weaknesses in our internal control over financial reporting existed at various times during the period from September 30, 2004 through September 30, 2006. These material weaknesses included excessive turnover and inadequate staffing levels in our accounting, financial reporting and tax departments, weaknesses in the preparation of our income tax provision, and weaknesses in our application of lease-related accounting principles, fresh-start reporting oversight, and account reconciliation procedures. Our independent registered public accounting firm attested and reported that our internal control over financial reporting was not effective as of December 31, 2005. We believe that each of these material weaknesses has now been adequately remediated. Although our management has concluded and our independent registered public accounting firm has attested and reported that our internal control over financial reporting was effective as of December 31, 2006, we cannot assure you that we will not discover other material weaknesses in the future. The existence of one or more material weaknesses could result in errors in our financial statements, and substantial costs and resources may be required to rectify these or other internal control deficiencies. If we cannot produce reliable financial reports, investors could lose confidence in our reported financial information, the market price of Leap's common stock could decline significantly, we may be unable to obtain additional financing to operate and expand our business, and our business and financial condition could be harmed.

Our Primary Business Strategy May Not Succeed in the Long Term.

A major element of our business strategy is to offer consumers service plans that allow unlimited calls from within a local calling area for a flat monthly rate without entering into a fixed-term contract or passing a credit check. However, unlike national wireless carriers, we do not seek to provide ubiquitous coverage across the U.S. or

Item 8. ***Financial Statements and Supplementary Data***

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders of Leap Wireless International, Inc.:

We have completed integrated audits of Leap Wireless International, Inc.'s 2006 and 2005 consolidated financial statements and of its internal control over financial reporting as of December 31, 2006, and an audit of its consolidated financial statements as of and for the five months ended December 31, 2004 in accordance with the standards of the Public Company Accounting Oversight Board (United States). Our opinions, based on our audits, are presented below.

Consolidated Financial Statements

In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of operations, of cash flows and of stockholders' equity (deficit) present fairly, in all material respects, the financial position of Leap Wireless International, Inc. and its subsidiaries (Successor Company) at December 31, 2006 and 2005, and the results of their operations and their cash flows for the years ended December 31, 2006 and 2005 and the five months ended December 31, 2004 in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit of financial statements includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As discussed in Note 2 to the consolidated financial statements, the United States Bankruptcy Court for the Southern District of California confirmed the Company's Fifth Amended Joint Plan of Reorganization (the "plan") on October 22, 2003. Consummation of the plan terminated all rights and interests of equity security holders as provided for in the plan. The plan was consummated on August 16, 2004 and the Company emerged from bankruptcy. In connection with its emergence from bankruptcy, the Company adopted fresh-start accounting as of July 31, 2004.

As discussed in Note 2 and Note 9 to the consolidated financial statements, the Company changed the manner in which it accounts for share-based compensation in 2006.

As discussed in Note 2 to the consolidated financial statements, the Company changed the manner in which it accounts for site rental costs incurred during the construction period in 2006.

Internal Control Over Financial Reporting

Also, in our opinion, management's assessment, included in Management's Report on Internal Control Over Financial Reporting appearing under Item 9A, that the Company maintained effective internal control over financial reporting as of December 31, 2006 based on criteria established in *Internal Control — Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), is fairly stated, in all material respects, based on those criteria. Furthermore, in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2006, based on criteria established in *Internal Control — Integrated Framework* issued by the COSO. The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express opinions on management's assessment and on the effectiveness of the Company's internal control over financial reporting based on our audit. We conducted our audit of internal control over financial reporting in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects.

An audit of internal control over financial reporting includes obtaining an understanding of internal control over financial reporting, evaluating management's assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we consider necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinions.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

PricewaterhouseCoopers LLP

San Diego, California
February 28, 2007

RECOMMENDED FOR FULL-TEXT PUBLICATION
Pursuant to Sixth Circuit Rule 206

File Name: 08a0318p.06

UNITED STATES COURT OF APPEALS

FOR THE SIXTH CIRCUIT

GLYNN LEY; PUBLIC EMPLOYEE'S RETIREMENT SYSTEM OF MISSISSIPPI, *Plaintiffs-Appellants,* *v.* VISTEON CORPORATION; PETER PESTILLO; MICHAEL JOHNSTON; DANIEL R. COULSON; JAMES PALMER; PRICEWATERHOUSECOOPER, L.L.P, *Defendants-Appellees.*	No. 06-2237

Appeal from the United States District Court
for the Eastern District of Michigan at Detroit.
No. 05-70737—Robert H. Cleland, District Judge.

Argued: July 29, 2008

Decided and Filed: August 26, 2008

Before: ROGERS and McKEAGUE, Circuit Judges; ADAMS, District Judge.*

COUNSEL

ARGUED: Kevin D. McHargue, BARON & BUDD, Dallas, Texas, for Appellants. John F. Hartmann, KIRKLAND & ELLIS, LLP, Chicago, Illinois, Peter W. Devereaux, LATHAM & WATKINS, LLP, Los Angeles, California, for Appellees. **ON BRIEF:** Kevin D. McHargue, Randall K. Pulliam, BARON & BUDD, Dallas, Texas, Lisa W. Shirley, SIMON, EDDINS & GREENSTONE, Dallas, Texas, Marc L. Newman, THE MILLER LAW FIRM, Rochester, Michigan, for Appellants. John F. Hartmann, Michael A. Duffy, KIRKLAND & ELLIS, Chicago, Illinois, John R. Trentacosta, FOLEY & LARDNER, LLP, Detroit, Michigan, Miles N. Ruthberg, LATHAM & WATKINS, LLP, Los Angeles, California, Janet M. Link, Michael J. Faris, LATHAM & WATKINS, Chicago, Illinois, for Appellees.

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*The Honorable John R. Adams, United States District Judge for the Northern District of Ohio, sitting by designation.

OPINION

McKEAGUE, Circuit Judge. Plaintiffs Glynn Ley and Public Employees' Retirement System of Mississippi (collectively, "Plaintiffs") appeal a district court's grant of Defendants' Visteon Corporation, Peter Pestillo, Michael Johnston, Daniel R. Coulson, James Palmer, and Pricewaterhousecooper, L.L.P., ("PwC") (collectively, "Defendants") motions to dismiss Plaintiffs' class action securities violation claims. Upon review of the record and the applicable law, we AFFIRM the judgment of the district court.

BACKGROUND

Plaintiffs, individually and on behalf of all others similarly situated, brought a complaint against Defendants for violations of the federal securities laws.[1] Each member of the Plaintiff Class purchased or otherwise acquired Visteon securities between June 28, 2000 and January 31, 2005 (the "Class Period"). Defendant Visteon is a global supplier of automotive systems, modules, and components to vehicle manufacturers and the automotive aftermarket. Defendants Pestillo, Johnston, Coulson, and Palmer (the "Individual Defendants") acted in the capacity of senior executive officers and/or directors of Visteon and Defendant PwC is a firm of certified public accountants engaged by Visteon during the Class Period.

Before its incorporation, Visteon operated as the unnamed parts division of Ford. Visteon was incorporated as a wholly owned subsidiary of Ford on January 5, 2000. On June 28 of that same year, Visteon was spun off (the "Spin-Off") as a separate publicly traded company. In connection with the Spin-Off, Ford and Visteon jointly filed a Prospectus and Registration Statement with the Securities and Exchange Commission (the "SEC").

On January 31, 2005, Visteon reported its preliminary fourth quarter and full year results for 2004, indicating a significant loss for 2004. In particular, Visteon reported errors in the company's accounting for certain benefits and income taxes. Plaintiffs allege that Visteon's "revelations shocked the market" and "[s]hares of Visteon fell $0.51 or 6.43 percent, on January 31, 2005, to close at $7.42 per share." (Am. Compl. ¶ 69.) On March 16, 2005, Visteon filed its amended Form 10-K for the period ending December 31, 2003. In that filing, Visteon indicated that its previously issued financial statements contained "$108 million in accounting errors which understated net losses by in excess of $60 million." (*Id.* at ¶ 70.) On May 10, 2005, Visteon announced it would delay filing its Form 10-Q for the quarterly period ending March 31, 2005 and reported errors in its "accruals for costs principally associated with freight and material surcharges." (*Id.* at ¶ 77.) Visteon's stock price reached a low of $3.14 on May 11, 2005. (*Id.* at ¶ 5.) Plaintiffs allege this "represented a decline of 60% from the end of the Class Period and a staggering drop of 86% from the Class Period high of $21.72 on August 1, 2001." (*Id.*) "During this time, Visteon shareholders lost $2.33 billion in market capitalization." (*Id.*)

In the Amended Complaint, Plaintiffs assert three claims. In Count I of the Amended Complaint against Defendants Visteon, Pestillo, and Coulson, Plaintiffs assert a § 11 claim pursuant to the Securities Act of 1933 (the "1933 or Securities Act"), 15 U.S.C. § 77k, on behalf of all persons who acquired Visteon's common stock in or traceable to the Spin-Off Prospectus, alleging

[1] Former named Plaintiff Glenn Ley filed the original complaint on February 25, 2005, joining Visteon and certain of its officers as defendants. Current named Plaintiff Public Employees' Retirement System of Mississippi filed the amended complaint on September 19, 2005 (the "Amended Complaint"), adding PwC as a defendant in one of the claims.

that Visteon's Spin-Off Prospectus was "inaccurate and misleading, contained untrue statements of material facts, and omitted to state material facts necessary to make the statements made not misleading." (*Id.* at ¶¶ 138-39.) In Count II of the Amended Complaint against all Defendants, Plantiffs assert a § 10(b) claim pursuant to Securities Exchange Act of 1934 (the "1934 or Exchange Act"), 15 U.S.C. § 78j(b), and SEC Rule 10b-5, 17 C.F.R. § 240.10b-5, alleging that Defendants "carried out a plan, scheme and course of conduct which was intended to and, throughout the Class Period, did: (i) deceive the investing public, including Plaintiff and other Class Members, as alleged herein; and (ii) cause Plaintiff and other members of the Class to purchase Visteon securities at artificially inflated prices." (*Id.* at ¶¶ 146-47.) In Count III of the Amended Complaint against the Individual Defendants, Plaintiffs assert a claim pursuant to § 20(a) of the Exchange Act, 15 U.S.C. § 78t(a), seeking to hold the Individual Defendants liable as "controlling persons." (*Id.* at ¶ 159.)

Visteon and the Individual Defendants filed a motion to dismiss Plaintiffs' claims. Defendant PwC filed a separate motion to dismiss. After a hearing on May 16, 2006, the district court granted both motions on August 31, 2006. *See Ley v. Visteon Corp.*, No. 05-CV-70737-DT, 2006 WL 2559795, at *11 (E.D. Mich. Aug. 31, 2006). Plaintiffs timely appeal followed.

STANDARD OF REVIEW

We review *de novo* a district court's dismissal of a complaint for failure to state a claim upon which relief can be granted under Fed. R. Civ. P. 12(b)(6). *See PR Diamonds, Inc. v. Chandler*, 364 F.3d 671, 680 (6th Cir. 2004). We "must accept as true 'well-pleaded facts' set forth in the complaint." *Id.* We must construe the complaint in a light most favorable to the plaintiffs and determine whether the plaintiffs undoubtedly can prove no set of facts in support of their claims that would entitle them to relief. *See id.* "In addition to the allegations in the complaint, the court may also consider other materials that are integral to the complaint, are public records, or are otherwise appropriate for the taking of judicial notice." *Wyser-Pratte Mgmt. Co. v. Telxon Corp.,* 413 F.3d 553, 560 (6th Cir. 2005) (citation omitted). Moreover, we may affirm on any grounds supported by the record, even though they may be different from the grounds relied on by the district court. *See Lawrence v. Chancery Court of Tenn.*, 188 F.3d 687, 691 (6th Cir. 1999).

ANALYSIS

Count I - § 11 claim

The district court dismissed Count I because Plaintiffs stated in their briefing that they did not oppose Defendants' motion to dismiss the claim based on a statute of limitations defense. Likewise, Plaintiffs have not argued the § 11 claim in their briefs before this court. Accordingly, we will not disturb the district court's dismissal of Plaintiffs' § 11 claim.

Count II - § 10(b) claim

In Count II of the Amended Complaint, Plaintiffs assert a claim under § 10(b) of the Exchange Act and Rule 10b-5 against all Defendants. On appeal, Plaintiffs challenge the propriety of the district court granting Defendants' motions to dismiss that claim.

Section 10(b) of the Exchange Act makes it unlawful to "use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered . . . any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors." 15 U.S.C. § 78j(b). Under Rule 10b-5, it is illegal for one "[t]o make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading . . . ." 17 C.F.R. § 240.10b-5.

We have explained that:

> Generally, federal securities law prohibits "fraudulent, material misstatements or omissions in connection with the sale or purchase of a security." *Morse v. McWhorter*, 290 F.3d 795, 798 (6th Cir. 2002). Specifically, in order to state a claim under Section 10(b) of the Securities Exchange Act of 1934, or under SEC Rule 10b-5, a plaintiff must allege: (1) a misrepresentation or omission; (2) of a material fact that the defendant had a duty to disclose; (3) made with scienter; (4) justifiably relied on by plaintiffs; and (5) proximately causing them injury. *Helwig v. Vencor, Inc.*, 251 F.3d 540, 554 (6th Cir. 2001) (en banc) (citing *Aschinger v. Columbus Showcase Co.*, 934 F.2d 1402, 1409 (6th Cir. 1991)); *see also* [*In re Sofamor Danek Group, Inc.*, 123 F.3d 394, 400 (6th Cir. 1997)]. A statement is said to be "actionable" when it satisfies the first two of these requirements, i.e., it is a misrepresentation or omission of a material fact that the defendant had a duty to disclose. *See, e.g., Nathenson v. Zonagen Inc.*, 267 F.3d 400, 415 (5th Cir. 2001); *Castellano v. Young & Rubicam, Inc.*, 257 F.3d 171, 179 (2d Cir. 2001).

City of Monroe Employees Ret. Sys. v. Bridgestone Corp., 399 F.3d 651, 668 (6th Cir. 2005).

We have also articulated that:

> Adding to the Federal Rule of Civil Procedure 9(b) requirement that fraud allegations be stated with particularity, the [Private Securities Litigation Reform Act of 1995 ("PSLRA"), 109 Stat. 737] requires that the complaint "specify each statement alleged to have been misleading, the reason or reasons why the statement is misleading, and, if an allegation regarding the statement or omission is made on information and belief, the complaint shall state with particularity all facts on which that belief is formed." 15 U.S.C. § 78u-4(b)(1).

PR Diamonds, Inc., 364 F.3d at 681. The Supreme Court has stated that "[e]xacting pleading requirements are among the control measures Congress included in the PSLRA. The Act requires plaintiffs to state with particularity both the facts constituting the alleged violation, and the facts evidencing scienter, *i.e.*, the defendant's intention 'to deceive, manipulate, or defraud.'" *Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 127 S.Ct. 2499, 2504 (2007) (citation omitted).

For purposes of clarity, we will separately address Plaintiffs' allegations below, discussing first Plaintiffs' allegations against Visteon and the Individual Defendants, and then against PwC.

A. Visteon and the Individual Defendants

1. Plaintiffs fail to allege a misrepresentation or omission of material fact regarding the Spin-Off claims

To state a claim under §10(b) or Rule 10b-5, Plaintiffs must allege that Defendants made a misrepresentation or omission of material fact that Defendant had a duty to disclose. *See City of Monroe Employees Ret. Sys.*, 399 F.3d at 668. Here, Plaintiffs allege that Visteon failed to disclose or partially disclosed various information at the time of the Spin-Off to disguise that Visteon was destined to fail.

Plaintiffs allege that Defendants failed to disclose that "Ford so dominated the day to day business affairs of Visteon via the contracts between the two and beholden Visteon management, such that Visteon was essentially no more than a repository for operations of Ford that had built in losses." (Am. Compl. ¶ 43.) Essentially, Plaintiffs argue that Defendants failed to adequately disclose that Visteon may have difficulty shedding unprofitable business lines. To the contrary, the

Spin-off Prospectus and subsequent disclosures were rife with such information. *See, e.g.,* J.A. 76, 370, 384, 397, 432.

Plaintiffs also allege that Defendants failed to disclose that "Visteon's cost structure resulting from the requirement to compensate Ford's UAW employees created a cost disadvantage as compared to the Company's competitors of at least $700 million to $1 billion." (Am. Compl. ¶ 43.) Yet, Visteon provided extensive information about its labor costs and even suggested such costs could impede its ability to compete. *See, e.g.,* J.A. 249-252, 289-90, 298-99.

Plaintiffs further allege that "Visteon's stated strategy could not be achieved as the Company was incapable of financial success as an independent entity due to the burdensome price restrictions exacted by Ford. . . ." (Am. Compl. ¶ 43.) However, Visteon disclosed it owed Ford certain price reductions. *See, e.g.,* J.A. 249-51, 262, 266, 296-97, 334-35.

Plaintiffs allege that "Visteon's lack of its own information technology department made it impossible for the Company to operate successfully as an independent Company." (Am. Compl. ¶ 43.) Yet, Visteon explicitly told investors it had to pay Ford for these services. *See, e.g.,* J.A. 297, 331, 335, 337, 382, 393, 407.

Plaintiffs allege Visteon failed to disclose that "Visteon management was so beholden to Ford that they did not act in the best interests of Visteon shareholders in negotiating the terms of the spin-off, nor were they prospectively capable of operating Visteon's business without subjugating the Company's interests to those of Ford's." (Am. Compl. ¶ 43.) To the contrary, a specific provision of the Prospectus disclosed that Visteon management "may have conflicts of interest when faced with decisions that could have different implications for our company and Ford." *See* J.A. 250; *see also* J.A. 302-307.

Plaintiffs also suggest that Visteon failed to disclose its dependence on Ford. However, Visteon's disclosures were replete with information about its dependence on Ford. *See, e.g.,* J.A. 248, 250, 263, 290, 374, 380, 392, 406.

Despite all of these disclosures by Visteon, Plaintiffs insist that Visteon had a duty to disclose even more. Specifically, Plaintiffs argue that they "never alleged that Visteon did not disclose its labor costs were high; rather, Plaintiffs' complaint is that Visteon did not reveal the truth regarding how high those costs were relative to Visteon's competition." Appellants' Br. at 29. Plaintiffs allege that an anonymous former Visteon employee said that there was "absolutely no way Visteon could be competitive." (Am. Compl. ¶ 38.) Yet, Defendants went so far as to disclose that "Visteon may incur wage differentials of 20-40% higher than the average competitor whose employees are not covered by a master UAW contract." J.A. 249. That Plaintiffs now argue that the differential percentage provided by Visteon was not high enough is part of the reason that there is simply no duty to disclose what Plaintiffs suggest and we will not advocate a rule that requires companies to draw such comparisons. In this respect, we find persuasive the Third Circuit's reasoning that:

> The federal securities laws do not ordain that the issuer of a security compare itself in myriad ways to its competitors, whether favorably or unfavorably, for at least three reasons. First, such a requirement would impose an onerous if not insurmountable obstacle on issuers of securities to ensure they obtain accurate information on all aspects of their competitors which a reasonable investor might find material. Second, were we to announce such a requirement, the likely result would be to inundate the investor with what the Supreme Court disparaged as "an avalanche of trivial information." [*TSC Indus., Inc. v. Northway, Inc.*, 426 U.S. 438, 448 (1976)]. Third-and of greatest consequence-it is precisely and uniquely the

> function of the prudent *investor, not* the issuer of securities, to make such comparisons among investments. *See* [*In re Donald J. Trump Casino Sec. Litig.*, 793 F.Supp. 543, 559 (D.N.J. 1992)].

In re Donald J. Trump Casino Sec. Litig.-Taj Mahal Litig., 7 F.3d 357, 375 (3d Cir. 1993).

In the same vein, Plaintiffs argue that they "did not allege that Visteon failed to disclose that Ford was its main customer and that it would be dependent on Ford for business, but rather that Visteon held itself out to be an independent entity when in fact it had no ability to operate as a viable independent company." Appellants' Br. at 31. Unfortunately for Plaintiffs, a company is not required to use the negative characterizations that Plaintiffs suggest. *See In re Donald J. Trump Casino Sec. Litig.-Taj Mahal Litig.*, 7 F.3d at 375 (stating companies do not need to use "pejorative nouns or adjectives") (citation omitted); *see also In re Sofamor Danek Group, Inc.*, 123 F.3d at 402 ("Whether the premium was so high that the company should have been able to predict that it would prove counterproductive was clearly a matter of opinion-soft information as to which there was no duty of disclosure.").

Here, Defendants provided investors with plenty of information to determine whether Visteon could operate as a viable independent company. That Plaintiffs would like even more disclosure misses the point that a violation of § 10(b) and Rule 10b-5 requires that the company have a duty to disclose information that is material. Defendants had no duty to disclose what Plaintiffs suggest and such information would not be considered material in any event. *Cf. Benzon v. Morgan Stanley Distribs., Inc.*, 420 F.3d 598, 609 (6th Cir. 2005) ("Given that all of the information necessary to compare the different class shares was in the prospectuses, the alleged omissions in this case are not material."); *see also In re Donald J. Trump Casino Sec. Litig.-Taj Mahal Litig.*, 7 F.3d at 375 ("In other words, an explicit statement in the prospectus that the Taj Mahal demanded an average daily casino win of $1.3 million to meet its debtload would have been superfluous."). In *Benzon*, we explained that:

> "Materiality depends on the significance the reasonable investor would place on the withheld ... information." *Helwig v. Vencor, Inc.*, 251 F.3d 540, 555 (6th Cir. 2001) (en banc). While statements of the type proposed by Plaintiffs *might* have facilitated an investor's task in comparing the share classes, the critical question is whether they would have "significantly altered the 'total mix' of information made available." *Id.* at 563 (quoting [*Basic Inc. v. Levinson,* 485 U.S. 224, 231-32 (1988)]). Given that the disclosures Plaintiffs propose are merely interpretations drawn from the facts presented in the prospectuses, and do not actually provide new information, they would not have "significantly altered the 'total mix'" of the information already presented in the prospectuses.

Benzon, 420 F.3d at 609. Plaintiffs fail to allege that Defendants made any actionable material misstatements or omissions and therefore the district court properly dismissed the Plaintiffs' Spin-Off-related claims.[2] In so holding, we have not applied the truth-on-the-market defense, and therefore, we reserve for another day the issue of whether that doctrine may be applied at the motion to dismiss stage of the pleadings.

2. Plaintiffs fail to allege a strong inference of scienter regarding the Restatement claims

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[2]While Plaintiffs object to the district court adopting Defendants' characterization of Plaintiffs' § 10(b) claim as encompassing both Spin-Off and Restatement-related claims, we find such characterizations are simply that, characterizations, and therefore we need not disturb the district court's opinion in this respect. In any event, whether we agree with the characterization would not change our decision in this case.

Plaintiffs must plead facts giving rise to a strong inference of scienter to avoid dismissal. While pleading claims for fraud always required a high level of particularity, *see* Fed. R. Civ. P. 9(b), the PSLRA requires an even higher standard for pleading scienter in a securities-fraud case:

> In any private action arising under this chapter in which the plaintiff may recover money damages only on proof that the defendant acted with a particular state of mind, the complaint shall, with respect to each act or omission alleged to violate this chapter, *state with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind.*

15 U.S.C. § 78u-4(b)(2) (emphasis added). Although the PSLRA does not define what constitutes the required state of mind, we have explained that knowing and deliberate intent to manipulate, deceive, or defraud, and recklessness may constitute scienter. *See In re Comshare Inc. Sec. Litig.*, 183 F.3d 542, 550 (6th Cir. 1999); *see also Ernst & Ernst v. Hochfelder,* 425 U.S. 185, 193 (1976).

The "strong inference" requirement means that plaintiffs are entitled only to the most plausible of competing inferences. *Helwig,* 251 F.3d at 555; *see also Tellabs, Inc.*, 127 S.Ct. at 2504-05 ("To qualify as 'strong' within the intendment [of the PSLRA], we hold, an inference of scienter must be more than merely plausible or reasonable-it must be cogent and at least as compelling as any opposing inference of nonfraudulent intent.").

In *Helwig*, we listed factors that, while not exhaustive, are probative of scienter in securities fraud cases:

> (1) insider trading at a suspicious time or in an unusual amount;
> (2) divergence between internal reports and external statements on the same subject;
> (3) closeness in time of an allegedly fraudulent statement or omission and the later disclosure of inconsistent information;
> (4) evidence of bribery by a top company official;
> (5) existence of an ancillary lawsuit charging fraud by a company and the company's quick settlement of that suit;
> (6) disregard of the most current factual information before making statements;
> (7) disclosure of accounting information in such a way that its negative implications could only be understood by someone with a high degree of sophistication;
> (8) the personal interest of certain directors in not informing disinterested directors of an impending sale of stock; and
> (9) the self-interested motivation of defendants in the form of saving their salaries or jobs.

Id. at 552.

On appeal, Plaintiffs identify six circumstances in their Amended Complaint that they argue give rise to a strong inference of scienter:

> (1) statements by corporate insiders that Visteon intentionally engaged in accounting improprieties in order to inflate earnings; (2) the statement by Individual Defendant Peter Pestillo, then-CEO of Visteon, that the Company had a "solid year" in 2002 when he knew that in fact the Company was barely liquid; (3) the Sarbanes-Oxley Certifications signed by Individual Defendants Michael Johnston and James Palmer that falsely certified Visteon's financial statements as free from material misstatement and protected by internal controls, particularly in light of the closeness in time between those Certifications in March 2005 and the restated earnings in August 2005; (4) the nature and magnitude of Visteon's accounting improprieties, amounting to at least $198 million over a four-year period; (5) Visteon's practice of

> reporting financial information in such a way that its negative implications could only be understood by someone with a high degree of sophistication; and (6) Visteon's motive and opportunity to improve Ford's financial performance by shifting Ford's losses to Visteon and perpetuating the falsehood that Visteon was a financially viable company.

Appellants' Br. at 39.

While we consider Plaintiffs' allegations in total when determining whether Plaintiffs sufficiently plead scienter, *see PR Diamonds, Inc.*, 364 F.3d at 683, we address each argument individually in this opinion for purposes of clarity.

i. Insider statements

Plaintiffs first argue that a strong inference of scienter is apparent because Visteon intentionally violated Generally Accepted Accounting Principles ("GAAP") to artificially inflate revenues. The support for Plaintiffs' assertions in this respect are limited to the statements of an anonymous source within Visteon. Plaintiffs explain that, according to a former senior finance director at Visteon, one accounting impropriety "involved the practice of booking customer rebates obtained from suppliers in the year the supplier contract was entered, even though the rebates had not yet actually been received." Appellants' Br. at 40. Plaintiffs allege that "[a]lthough GAAP requires the rebates to be spread over the life of the contract, Visteon's motive for doing so was to 'falsely improve the Company's financial condition by lowering costs through booking future rebates in one period.'" (Am. Compl. ¶ 79.) "Also according to a former senior finance director at Visteon, Visteon's suppliers would routinely pass along increases in the price of materials for the goods sold to Visteon." (Am. Compl. ¶ 80.) "Rather than book these material surcharges in the period in which they occurred as required by GAAP, Visteon would 'defer' these surcharges and not account for them in its financial statements." (*Id.*) Plaintiffs allege Visteon's motive was to not report "the cash that was actually going out the door." (*Id.*)

While we agree that anonymous sources are not altogether irrelevant to the scienter analysis, Plaintiffs' allegations here are too vague and conclusory to be accorded much weight. *See Higginbotham v. Baxter Int'l Inc.*, 495 F.3d 753, 757 (7th Cir. 2007) (finding allegations of confidential witnesses must be discounted and "[u]sually that discount will be steep"). Indeed, Plaintiffs fail to allege who at Visteon knew about these alleged accounting improprieties and what, when, where, and how they knew. Without such context, we cannot say the statements raise an inference of scienter.

ii. Pestillo statement

Plaintiffs allege that Defendant Pestillo's statement in January 2003 that Visteon "had a solid year in 2002" while at the same time the Company was internally saying it was "not doing well," barely had enough money to pay its bills," and was "barely liquid" is evidence of scienter. (Am. Compl. ¶ 33.) We agree with the district court that this statement was "corporate optimism," and not probative of scienter. *See In re Ford Motor Co. Sec. Litig.*, 381 F.3d 564, 570 (6th Cir. 2004) ("Such statements are either mere corporate puffery or hyperbole that a reasonable investor would not view as significantly changing the general gist of available information, and thus, are not material, even if they were misleading."). Moreover, the context of the statement involves a press release wherein Visteon had just prior to Pestillo's comment stated 2002 earnings were higher than 2001 earnings and therefore Plaintiffs are wrong to suggest that Pestillo was commenting on liquidity when he was commenting about earnings. *See In re Donald J. Trump Casino Sec. Litig.-Taj Mahal Litig.*, 7 F.3d at 371 ("[W]e must consider an alleged misrepresentation within the context in which the speaker communicated it"); *cf. Helwig*, 251 F.3d at 552 (stating one of the factors for scienter analysis is "divergence between internal reports and external statements *on the same*

subject") (emphasis added). For that reason, Plaintiffs reliance on *Virginia Bankshares, Inc. v. Sandberg,* 501 U.S. 1083, 1092 (1991) is also misplaced.

iii. Certifications

Plaintiffs contend that Pestillo's and Palmer's signatures on the Sarbanes-Oxley certifications are evidence of scienter. (Am. Compl. ¶87.) The district court declined "to interpret the signed certifications as evidence of scienter, as doing so would be to hold company executives strictly liable for innocent accounting mistakes." *Ley*, 2006 WL 2559795, at *9. We agree with the Eleventh Circuit that a "Sarbanes-Oxley certification is only probative of scienter if the person signing the certification was severely reckless in certifying the accuracy of the financial statements." *See Garfield v. NDC Health Corp.*, 466 F.3d 1255, 1266 (11th Cir. 2006); *see also Cent. Laborers' Pension Fund v. Integrated Elec. Servs. Inc.*, 497 F.3d 546, 554-55 (5th Cir. 2007). Here, Plaintiffs fail to allege facts to suggest that Pestillo or Palmer had reason to know or should have suspected accounting irregularities or other "red flags" at the time they signed the certifications. Indeed, Plaintiffs have not explained the link between these statements and the actual accounting issues at Visteon. Therefore, we agree with the district court that the signatures are not probative of scienter.

iv. Nature and magnitude of accounting improprieties

Plaintiffs also argue that the nature and magnitude of Visteon's accounting improprieties warrant an inference of recklessness. Appellants' Br. at 48-49. Defendants urge us to reject this argument outright based on our court's proclamation that "[w]e decline to follow the cases that hold that the magnitude of the financial fraud contributes to an inference of scienter on the part of the defendant." *Fidel v. Farley*, 392 F.3d 220, 231 (6th Cir. 2004). However, in *PR Diamonds, Inc.*, 364 F.3d at 685, this court considered the magnitude and nature of the accounting issues, but held that "the accounting irregularities Plaintiffs allege in this case are significantly less egregious in nature and magnitude and thus do not support a strong inference [of scienter]."

Even if we consider whether the nature and magnitude of the accounting errors support an inference of scienter, we agree with the district court that they do not here. First, we agree with the district court that the accounting errors here were not "so simple, basic, or pervasive in nature" to have been obvious to the Defendants. *PR Diamonds, Inc.*, 364 F.3d at 684. Indeed, the errors involve amendments to retiree health benefit plans, amount and time of certain tax adjustments and changes to deferred taxes, corrections for certain tooling costs and volume related rebates, inventory costing corrections, unrecorded pension expenses related to European operations and postretirement health care expenses in a foreign location, errors related to freight expenses, material surcharges and supplier expenses. (Am. Compl. ¶¶ 68, 70, 78.) Likewise, we agree with the district court that said errors were not "so great in magnitude" to be obvious to Defendants. *PR Diamonds, Inc.*, 364 F.3d at 684. The district court points out that Plaintiffs themselves, in briefing before the district court, only alleged that Defendants overstated its total revenues by 5.68% during the Class Period. *See* J.A. 1083. While we do not necessarily advocate a rigid adherence to percentages, such a low percentage of change to total revenue does not strike us as the type of "'in your face facts' that 'cry out' scienter." *PR Diamonds, Inc.*, 364 F.3d at 686.

We do not dispute that a "Restatement, under Accounting Principles Board Opinion (APB) No. 20, is a 'correction of errors in previously issued financial statements.'" *Frank v. Dana Corp.*, 525 F.Supp. 2d 922, 929 (N.D. Ohio 2007); *see also In re Goodyear Tire & Rubber Co. Sec. Litig.*, 436 F.Supp.2d 873, 894 (N.D. Ohio 2006) ("By definition. . . a restatement says that the prior financial statement was false."). Here, however, Plaintiffs fail to allege any particularized facts to suggest that the statements were knowingly or recklessly false at the time they were made to the market and therefore Plaintiffs seek to hold Defendants accountable for nothing more than a Restatement of its financials.

v. Reporting practices

Plaintiffs allege that Visteon's disclosures "were often presented in an intentionally confusing manner" and therefore raise an inference of scienter. Appellants' Br. at 52. "In this regard, Visteon chose to conceal the losses on the Ford contracts that were inherent at the time of the Spin-Off by reporting those losses in multiple documents that could only be fully understood when read together." *Id.* Plaintiffs also allege that "[s]imilarly, the 2004 consolidated financial statements did not simply state the truth, which was that the cash from operations would apparently not be sufficient to cover operating costs and other cash needs" and instead "[t]his fact was disclosed piecemeal in two separate notes to the 2004 consolidated financial statements that had to be read together." *Id.* at 53. Again, what Plaintiffs want is for Defendants to couch the financial health of Visteon in the negative terms of their choosing, but that is not required under the federal securities laws. Plaintiffs do not argue the information they seek was not disclosed, but rather it was disclosed in a misleading way. However, Plaintiffs fail to cite any authority for their argument that disclosure in two separate notes to the financials under these circumstances is problematic and we find none.

vi. Motive and opportunity

Plaintiffs also argue that Defendants' motive and opportunity to commit fraud supports a strong inference of scienter. Most of Plaintiffs' motive and opportunity allegations do not raise an inference of scienter, let alone a strong one, and do not warrant further discussion here. *See PR Diamonds, Inc.*, 364 F.3d at 690 ("All corporate managers share a desire for their companies to appear successful. That desire does not comprise a motive for fraud."); *In re Comshare Inc. Sec. Litig.*, 183 F.3d at 551 ("[W]e hold that plaintiffs may meet PSLRA pleading requirements by alleging facts that give rise to a strong inference of reckless behavior *but not by alleging facts that illustrate nothing more than a defendant's motive and opportunity to commit fraud.*") (emphasis added).

However, we briefly will address Plaintiffs more specific allegation that Defendants' motive was a March 2004 note offering to raise additional capital and to avoid defaulting on existing notes. (Am. Compl. ¶ 134). In *PR Diamonds, Inc.*, we addressed a similar allegation in which the plaintiffs alleged that defendants "were motivated to engage in fraud in order to forestall Intrenet's default of its bank loan agreement and to preserve the Company's ability to borrow pursuant to its credit facility." 364 F.3d at 690. There, we explained that we "view the motive allegations concerning the bank loan and credit facility as suggestive of scienter, although standing alone they do not establish a strong inference." *Id.*; *see also Key Equity Investors, Inc. v. Sel-Leb Marketing, Inc.*, 246 F. App'x 780, 786 n.10 (3d Cir. 2007) (stating that "the complaint sets out nothing more than an ordinary business motive, which is typically insufficient to support a strong inference of fraud" wherein plaintiffs alleged that a company falsified its earnings to maintain its credit line). Here, Plaintiffs fail to allege any particularized facts or details related to the notes offering that support an inference of scienter. As the Third Circuit explained:

> In this case, although Key Equity alleges that Sel-Leb falsified its earnings to maintain its credit line, its complaint is bereft of any facts or details supporting this conclusion. We are therefore left to speculate about what particular information was hidden, what financial figures were manipulated, and when any of the defendants knew of or implemented such fraudulent devices. *Cf.* [*In re Burlington Coat Factory Sec. Litig.*, 114 F.3d 1410, 1417-18 (3d Cir. 1997)] ("[W]here plaintiffs allege that defendants distorted certain data disclosed to the public by using unreasonable accounting practices, we have required plaintiffs to state what the unreasonable practices were and how they distorted the disclosed data."). Inferring *scienter* in these circumstances would impermissibly provide Key Equity the "benefit [of]

> inferences flowing from vague or unspecific allegations." [*In re Rockefeller Center Prop., Inc. Sec. Litig.*, 311 F.3d 198, 224 (3d Cir. 2002)]. In other words, because of the complaint's omissions, it fails to set out the "who, what, when, where and how" of the events at issue. [*DiLeo v. Ernst & Young*, 901 F.2d 624, 627 (7th Cir. 1990)].

Key Equity Investors, Inc., 246 F. App'x at 786-87. The same is true here.

We find that Plaintiffs' allegations, taken together and viewed collectively, fail to adequately plead a strong inference of scienter on the part of Visteon and the Individual Defendants. Accordingly, the district court properly dismissed the Plaintiffs' Restatement-related claims.

B. PwC

The district court also concluded that Plaintiffs failed to allege a strong inference of scienter on the part of PwC and therefore dismissed Plaintiffs' § 10(b) claim with respect to PwC. We agree.

We have explained the pleading standard as applied to an outside auditor:

> The same PSLRA pleading standards . . . apply to the allegations against Andersen. However, the meaning of recklessness in securities fraud cases is especially stringent when the claim is brought against an outside auditor. *In re SmarTalk Teleservices, Inc. Secs. Litig.*, 124 F.Supp.2d 505, 514 (S.D. Ohio 2000). Recklessness on the part of an independent auditor entails a mental state so culpable that it "approximate[s] an actual intent to aid in the fraud being perpetrated by the audited company." *Decker v. Massey-Ferguson, Ltd.*, 681 F.2d 111, 121 (2d Cir. 1982); *Pegasus Fund, Inc. v. Laraneta*, 617 F.2d 1335, 1341 (9th Cir. 1980) (auditor's recklessness "must come closer to being a lesser form of intent (to deceive) than merely a greater degree of ordinary negligence") (internal quotations omitted). Scienter "requires more than a misapplication of accounting principles. The [plaintiff] must prove that the accounting practices were so deficient that the audit amounted to no audit at all, or an egregious refusal to see the obvious, or to investigate the doubtful, or that the accounting judgments which were made were such that no reasonable accountant would have made the same decisions if confronted with the same facts." *In re Worlds of Wonder Secs. Litig.*, 35 F.3d 1407, 1426 (9th Cir. 1994) (quoting *SEC v. Price Waterhouse*, 797 F.Supp. 1217, 1240 (S.D.N.Y. 1992)).
>
> "When the standard of recklessness for an auditor is overlaid with the pleading requirements of the PSLRA, a simple rule emerges: to allege that an independent accountant or auditor acted with scienter, the complaint must allege specific facts showing that the deficiencies in the audit were so severe that they strongly suggest that the auditor must have been aware of the corporation's fraud." *SmarTalk*, 124 F.Supp.2d at 514 (citing *Hollinger v. Titan Capital Corp.*, 914 F.2d 1564, 1570 (9th Cir. 1990) and *In re Software Toolworks, Inc.*, 50 F.3d 615, 628 (9th Cir. 1994)). "[T]o allege that an independent accountant or auditor acted with scienter, the complaint must identify specific, highly suspicious facts and circumstances available to the auditor at the time of the audit and allege that these facts were ignored, either deliberately or recklessly." *SmarTalk*, 124 F.Supp.2d at 515.

PR Diamonds, Inc., 364 F.3d at 693-94. PwC's liability, if any, is limited to its making misstatements or omissions, not simply giving aid to a person making a material misstatement or omission. *See Fidel*, 392 F.3d at 235.

On appeal, Plaintiffs argue that the following circumstances give rise to a strong inference that PwC either deliberately or recklessly disregarded the problems with Visteon's accounting practices: "(1) PwC's failure to maintain its professional independence; (2) the nature and magnitude of Visteon's GAAP violations known to PwC; (3) PwC's unqualified audits to Visteon's related party transactions with Ford in violation of [Generally Accepted Auditing Standards ("GAAS")]; and (4) PwC's intimate knowledge of Visteon's internal financial information." Appellants' Br. at 58.

1. Failure to maintain professional independence

PwC was an auditor for both Visteon and Ford at the time of the Spin-Off and after. Plaintiffs appear to argue that because PwC received more fees from Ford than Visteon, PwC was motivated to favor Ford to the detriment of Visteon. Appellants' Br. at 58-59. We have rejected a similar allegation of motive:

> In addition, the class members argue that Ernst & Young's desire to keep Fruit of the Loom as a client creates a strong inference of Ernst & Young's scienter. They allege that Ernst & Young reaped significant fees from its relationship with Fruit of the Loom that it did not want to jeopardize by calling attention to Fruit of the Loom's poor financial condition. However, allegations that the auditor earned and wished to continue earning fees from a client do not raise an inference that the auditor acted with the requisite scienter. At best, they set forth a motive for the auditor to have engaged in fraud. Bare allegations of motive are insufficient to adequately plead scienter. As we observed in *Helwig*, "facts presenting motive and opportunity may be of enough weight to state a claim under the PSLRA, whereas pleading conclusory labels of motive and opportunity will not suffice." 251 F.3d at 551. We further clarified in *Comshare* that a plaintiff cannot meet PSLRA's pleading requirements by "alleging facts that illustrate nothing more than a defendant's motive and opportunity to commit fraud." 183 F.3d at 551. The plaintiffs in this case do nothing more than state facts that establish Ernst & Young had a motive to commit fraud; their complaint alleges that Fruit of the Loom was a lucrative client from which Ernst & Young earned millions of dollars each year. While this information suggests that Ernst & Young benefitted from its relationship with Fruit of the Loom, it would be mere speculation to rely on this evidence to establish that Ernst & Young acted knowingly or recklessly in preparing the audit report. *See id.* at 554 (a pleading under the PSLRA cannot rest on speculation or conclusory allegations).
>
> Further, Ernst & Young would always be motivated to maintain positive relations with a current client, and there is no indication that its motive to retain Fruit of the Loom as a client was any different than its general motive to retain business. Absent any allegations that Ernst & Young's fees from Fruit of the Loom were more significant than its fees from other clients or that Fruit of the Loom represented a significant portion of Ernst & Young's revenue, it is difficult to surmise how Ernst & Young's desire to keep Fruit of the Loom as a client would be any different from its desire to keep any client and thus be indicative of fraud. *Cf. PR Diamonds,* 364 F.3d at 690 (observing that courts "distinguish motives common to corporations and executives generally from motives to commit fraud"); [*Kennilworth Partners L.P. v. Cendant Corp.*, 59 F.Supp.2d 417, 429 (D.N.J. 1999)] ("[S]tatement[s that] could be made in relation to the auditor of every corporation" are not sufficient to raise the inference of scienter.).

Fidel, 392 F.3d at 232-33. The same can be said here.

2. Nature and magnitude of Visteon's GAAP violations

Plaintiffs argue that the nature and magnitude of Visteon's GAAP violations "are relevant to PwC's state of mind because PwC effectively enabled Visteon to use fundamentally flawed accounting practices in preparing its financial statements for 2001, 2002, 2003, and the first three quarters of 2004, by either knowingly or recklessly disregarding obvious and pervasive red flags indicating material deficiencies in Visteon's operations and internal controls." Appellants' Br. at 60.

We have squarely addressed similar allegations of scienter based on the nature and magnitude of the accounting errors with respect to an outside auditor and explained that:

> [T]he class members contend that the magnitude of the financial fraud allegedly perpetuated by Fruit of the Loom bolsters the inference that [outside auditor] Ernst & Young acted with scienter.
>
> ***
>
> We decline to follow the cases that hold that the magnitude of financial fraud contributes to an inference of scienter on the part of the defendant. Allowing an inference of scienter based on the magnitude of fraud "would eviscerate the principle that accounting errors alone cannot justify a finding of scienter." *In re SCB Computer Tech., Inc. Sec. Litig.*, 149 F.Supp.2d 334, 359 (W.D. Tenn. 2001); *see also In re Comshare Inc. Sec. Litig.*, 183 F.3d at 553 (holding that the failure to follow accounting standards "is, by itself, insufficient to state a securities fraud claim"). It would also allow the court to engage in speculation and hindsight, both of which are counter to the PSLRA's mandates.

Fidel, 392 F.3d at 231; *see also In re MicroStrategy, Inc. Sec. Litig.*, 115 F. Supp. 2d 620, 637 n.34 (E.D. Va. 2000) (suggesting that the nature and magnitude of accounting errors may be relevant to the scienter analysis as it applies to corporate defendants, but not outside auditors). Even if the magnitude of the accounting errors were relevant in general terms to scienter of an outside auditor, the magnitude here was not sufficient to raise a strong inference of scienter, as discussed *supra*. We have emphasized that improper accounting alone does not establish scienter:

> Even if Ernst & Young had restated the figures used in its audit, this action would not have risen to the level of establishing scienter. We have held that "a subsequent revelation of the falsehood of previous statements" does not imply scienter, because " '[m]ere allegations that statements in one report should have been made in earlier reports do not make out a claim of securities fraud.' " *In re Comshare,* 183 F.3d at 553 (quoting *Stevelman v. Alias Research, Inc.*, 174 F.3d 79, 84 (2d Cir. 1999)). Therefore, it follows that even if Ernst & Young should have included the write-offs in its audit or that the audit report contained false statements because it did not include write-offs occurring during that year, Ernst & Young's actions do not create an inference that it acted with the requisite scienter.

Id.

Plaintiffs also allege that PwC disregarded "red flags," *see* Appellants' Br. at 60, but they fail to identify any specific "red flags" that raise a strong inference of scienter. Plaintiffs cite their Amended Complaint; however, it details only GAAS violations that fail to create an inference of scienter. *See PR Diamonds, Inc.*, 364 F.3d at 695 (distinguishing "[t]wo of the purported red flags [that] simply repeat the alleged GAAP improprieties" from the "genuine red flag"). The only other indicator that Plaintiffs point to as a "red flag" appears to be a statement by an anonymous witness. Plaintiffs allege that "[a]ccording to a former senior finance director at Visteon, PwC had raised concerns with Visteon management regarding the accounting for material surcharges and rebates,

but 'signed off' on those accounting practices several times." Appellants' Br. at 60. Because this allegation lacks specificity and originates from an anonymous source, we are not inclined to accord it much weight in our analysis. *See Higginbotham*, 495 F.3d at 757. Moreover, Plaintiffs fail to allege particularized facts about the who, what, where, when, and how of what PwC knew or disregarded about Visteon's accounting practices, rendering the statement even less probative of scienter.

3. PwC's unqualified audits to Visteon's related party transactions with Ford in violation of GAAS

Plaintiffs allege that "the evidence of PwC's disregard for these related party transactions demonstrates that PwC either knew or recklessly disregarded Visteon's undisclosed status as a de facto subsidiary or SPE of Ford." Appellants' Br. at 62. These allegations are another attempt to couch alleged GAAS violations as evidence of scienter. Yet, Plaintiffs fail to plead any particularized facts to show that these purported violations "strongly suggest that [PwC] must have been aware of the corporation's fraud." *PR Diamonds*, 364 F.3d at 694.

4. PwC's intimate knowledge of Visteon's internal financial information

Plaintiffs also allege that PwC's "continual access to Visteon's confidential financial statements and business problems" further supports a strong inference of scienter. (Am. Compl. ¶ 12.) In the context of an outside auditor, we have explained that:

> According to the Complaint, Andersen's personnel were regularly present at Intrenet's corporate headquarters throughout the class period and had continual access to, and knowledge of, Intrenet's confidential financial and business information. These allegations, by themselves, are not enough to raise a strong inference of scienter because such allegations are insufficiently concrete to support such an inference. *See, e.g.,* [*Kennilworth Partners L.P.*, 59 F.Supp.2d at 429] ("[S]tatement[s that] could be made in relation to the auditor of every corporation" are insufficient to plead scienter, for "[i]f it were sufficient ..., it might make every auditor liable in cases of securities fraud."). However, while the mere fact that an auditor has access to a company does not necessary mean that it was aware of alleged fraud at the company, the greater the auditor's "access to and involvement with" the company's operations, the more support an inference of scienter takes on. *MicroStrategy*, 115 F.Supp.2d at 653.

PR Diamonds, Inc., 364 F.3d at 695-96. We, therefore, take into account PwC's access to information but find it does not suggest a strong inference of scienter. *See id.* at 696. The Amended Complaint fails to allege what documents in particular PwC had access to or what information it would have learned from reviewing said documents. Indeed, Plaintiffs' allegations are insufficiently concrete to raise an inference of scienter, much less a strong one. *See id.* at 695-96; *see also Fidel*, 392 F.3d at 229-30.

Although we addressed each of Plaintiffs' allegations separately for purposes of this opinion, our ultimate conclusion is that Plaintiffs have failed to adequately plead scienter.[3] Plaintiffs have failed to meet their burden of pleading specific facts, which, when viewed cumulatively, persuade us that the most plausible conclusion is that Defendants must or should have known about Visteon's problems. "While the allegations no doubt merit drawing *some* inference of scienter, that is not enough. The PSLRA requires the [Amended] Complaint to establish a *strong* inference [of

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[3] Moreover, despite Plaintiffs' suggestion to the contrary, we find that the district court also applied the appropriate totality of the circumstances test.

scienter]." *PR Diamonds Inc.*, 364 F.3d at 684 (emphasis in original). Plaintiffs failed to show that Defendants, whether it be Visteon, the Individual Defendants, or PwC, "acted at least recklessly, meaning that their states of mind were reflected in highly unreasonable conduct constituting an extreme departure from the standards of ordinary care so obvious that any reasonable person would have known of it." *Id.* Accordingly, the district court properly dismissed the Amended Complaint.

Count III - § 20(a) claim

The district court also dismissed Plaintiffs' § 20(a) Act claim against all Individual Defendants because it found no predicate violation of §§ 11, 10(b), or Rule 10b-5 by any of the Defendants. Because we agree with the district court that there is no predicate violation of the securities laws here, we likewise affirm the district court's dismissal of Plaintiffs' § 20(a) claim. *See id.* at 698 ("Because the Complaint fails to state an underlying securities law violation by a controlled person, we need not address the subsequent question of whether the Individual Defendants possessed an adequate degree of control to support a Section 20(a) claim.").

CONCLUSION

For all the aforementioned reasons, we AFFIRM the judgment of the district court.[4]

[4]Because of our holding today, we do not express an opinion about whether Plaintiffs properly have alleged loss causation or the propriety of Plaintiffs' relying on the group pleading doctrine in their Amended Complaint.